



Insurance Contracts

First Impressions

IFRS 17

July 2017

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A whole new perspective

The watching and waiting is over; it's time to get started.

It's the dawn of a new era. After some 20 years of discussion, exposure drafts and debate, the comprehensive new accounting model in IFRS 17 *Insurance Contracts* will give users of financial information a whole new perspective on insurers' financial statements.

The new standard brings greater comparability and transparency about the profitability of new and in-force business and gives users more insight into an insurer's financial health than ever before. Separate presentation of underwriting and financial results will give added transparency about the sources of profits and quality of earnings.

But what does IFRS 17 mean for insurers?

The impact will vary significantly from company to company, depending on previous accounting policies and practices. But we are certain to see many and various impacts on the reported numbers.

Preparing for and implementing the new standard will present challenges. It will require substantial effort, and new or upgraded systems, processes and controls. Co-ordination between functions such as Finance, Actuarial and IT will be essential, and it will be important to educate business users and investors on what to expect. But it's also an opportunity – a change of this magnitude is a chance to gain new insights from data analysis and reporting, and to improve process efficiency.

This *First Impressions* provides an overview of the new standard and how it may affect insurers' financial statements. It includes examples and our insights to help you assess the potential impacts and to prepare for 2021.

Joachim Kölschbach

Mary Trussell

Alan Goad

Chris Spall

KPMG's global IFRS insurance contracts leadership team

KPMG International Standards Group

1 IFRS 17 at a glance

IFRS 17 introduces a new measurement model for insurance contracts and becomes effective in 2021.

1.1

Key facts

Topic	
Scope	<ul style="list-style-type: none"> – Similar to IFRS 4 <i>Insurance Contracts</i>.
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 future cash flows; – discounting; and – a risk adjustment for non-financial risk. - The contractual service margin (CSM), which represents the unearned profit the entity will recognise as it provides services over the coverage period. – Fulfilment cash flows representing a net outflow on initial recognition are 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 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 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 are excluded from insurance revenue and insurance service expenses. – Insurance service results are 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 2021 – Early adoption is permitted if IFRS 9 <i>Financial Instruments</i> and IFRS 15 <i>Revenue from Contracts with Customers</i> are applied at the adoption date or earlier.
Transition	<ul style="list-style-type: none"> – Full retrospective application is required – however, if it is impracticable, a modified retrospective approach and a fair value approach are available. – 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. Global comparability and increased transparency will give users more insight into an insurer's financial health.

Greater volatility in financial results and equity. The effect of using current market discount rates will vary, but it is likely to be significant in many cases, resulting in greater volatility in financial results and equity. 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' as investment components and cash received are no longer 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 have on an insurer's results will be presented separately from insurance performance, providing a clearer picture of profit drivers.

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

Non-life sector impacts. Non-life insurers will need to navigate the criteria to qualify for the PAA in order to retain familiar accounting models. 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 will enter new territory.

Communication challenges. New presentation and disclosure requirements will change the way performance is communicated. Entities will need to design new 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.

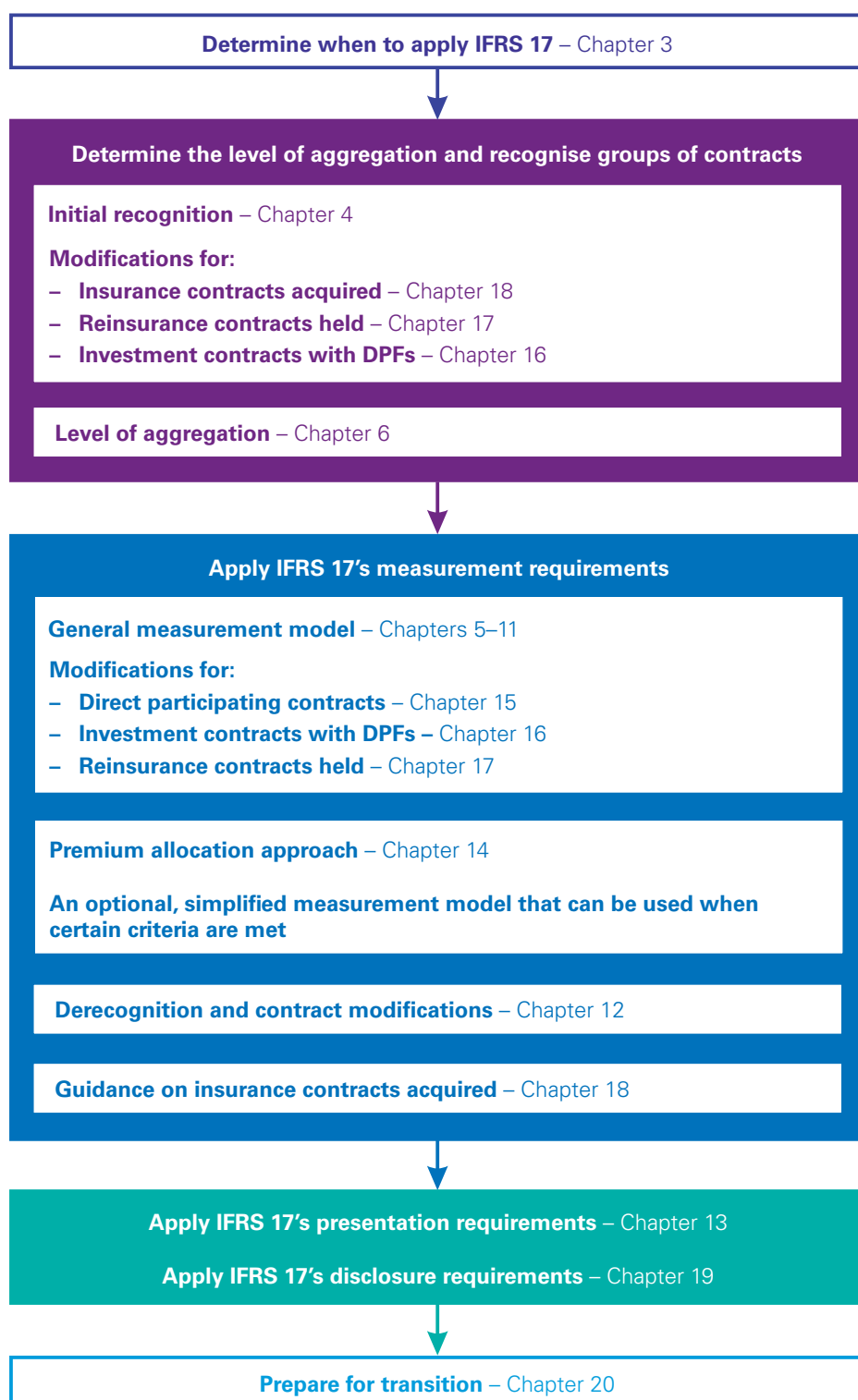
Scarce resources under pressure. The human talent required to operationalise IFRS 17's requirements and translate theory into practice is significant.

Opportunities for streamlining and greater efficiency. Change brings opportunity. Insurers that have already started to analyse the standard see opportunities to streamline through greater use of shared service centres and centralisation.

Some impacts cannot yet be determined. IFRS 17 may trigger a second wave of activity by 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 applies to fees and related costs on investment management contracts.

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

- 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.

IFRS 17.3

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	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.	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

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 that 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 the 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

IFRS 17.A, B11

What is insurance risk?

‘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
<div>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</div>	<div>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</div>

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 of the contract.



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.



KPMG insight – 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 – 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.

3.1.1.2.2

IFRS 17B8

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.



KPMG insight – 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.

If the holder of a residual value guarantee uses the asset in its business and can exercise the guarantee only by returning the asset to the guarantor, then the holder's decision to exercise the guarantee will be influenced not only by the market price of the asset, but also by its value in use and the availability of alternative assets for use in the business. In our view, it would be reasonable to conclude in these cases that the underlying variable driving the value of the guarantee to the holder is specific to the holder of that guarantee. Therefore, the contract can meet the definition of an insurance contract even if the holder is required to restore the asset to a specified condition before returning it (if the other parts of the definition are met).

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, it 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.



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 17.B20

IFRS 17B18, B21



KPMG insight – 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 determines 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 it 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 the 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.



KPMG insight – 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.

IFRS 17BC83

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.

IFRS 17.7(a), B26(g), BC89–BC90

IFRS 17.7(b)

IFRS 17.7(b)

IFRS 17.7(c)

Not in scope	Applicable accounting standard(s), and additional explanation/examples
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>
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>
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>
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
IFRS 17.7(d)	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
IFRS 17.7(e)	Financial guarantee contracts – unless the issuer met certain requirements and made 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>
IFRS 17.7(f)	Contingent consideration payable or receivable in a business combination	<ul style="list-style-type: none"> – IFRS 3 <i>Business Combinations</i>
IFRS 17.7(g)	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.

3.1.4

IFRS 17BC95

IFRS 17B6

IFRS 178

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 17BC95

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.



KPMG insight – 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 17B29, IFRS 9.A

IFRS 17B27(f), B29–B30

IFRS 177(e), B29

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 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.

An entity is not required to apply IFRS 17 to 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.



KPMG insight – What does ‘previously asserted explicitly’ mean in practice?

IFRS preparers 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 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.



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:

- investments in some types of catastrophe bonds and subordinated liabilities (see 3.1.1.2);
- 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).

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

IFRS 17.10, BC98

Separating components from an insurance contract

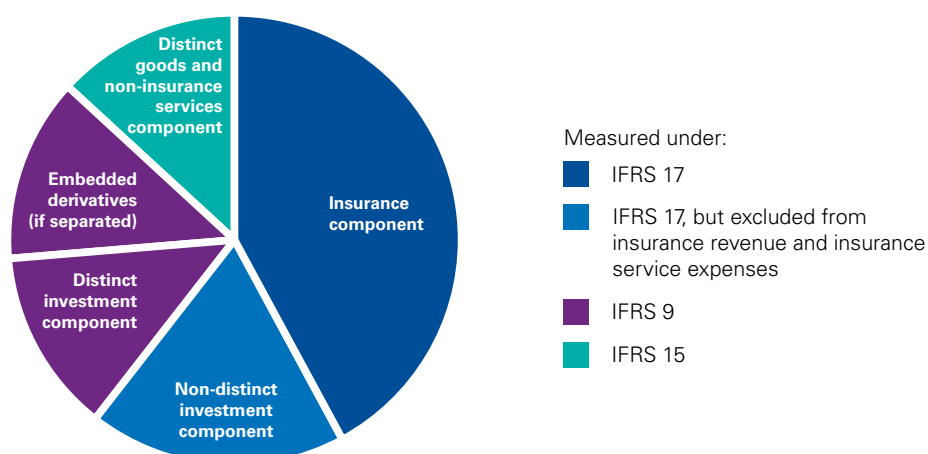
Insurance contracts create a bundle of rights and obligations that work together to generate a package of cash flows. Some types of insurance contracts only provide insurance coverage – e.g. most short-term non-life contracts.

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. non-insurance 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 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 to a policyholder even if an insured event does not occur.

An investment component is separated from the host insurance contract and accounted for in accordance with IFRS 9 if it is 'distinct'.

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 17.85

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.

IFRS 17B10

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

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
Embedded derivatives that are not separated because they are insurance contracts	<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.
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.

Type of embedded derivative	Example
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. – Persistency bonus paid at maturity in cash.

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 fair value through profit or loss (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 interdependent, 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 non-insurance services components

A promise to provide goods or non-insurance 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.

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 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 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

**KPMG insight – 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.

**KPMG insight – 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 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 non-insurance 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 non-insurance 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 non-insurance 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

IFRS 17.25–26

When to recognise a group of contracts

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 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 issued by the reporting date. New contracts are added to the group in subsequent reporting periods in which any new contracts are issued.

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 2021.
- The coverage period of the insurance contract starts on 1 January 2022, which is also the premium due date.
- This example assumes that the group comprises only this contract.

Analysis

On 1 June 2021 and at each reporting date between 1 June 2021 and 31 December 2021 – 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 2022.



KPMG insight – 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 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 17.27

Insurance acquisition cash flows

An entity:

- recognises an asset or liability for any insurance acquisition cash flows relating to a group of issued insurance contracts that it pays or receives before the group is recognised; and
- derecognises that asset or liability when the group of insurance contracts is recognised.

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



KPMG insight – 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.

IFRS 17.BC145

5

The general measurement model – Overview

IFRS 17.1

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

5.1

IFRS 17.1N5, BC18

Introducing the model

Insurance contracts may be highly complex bundles of interdependent 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

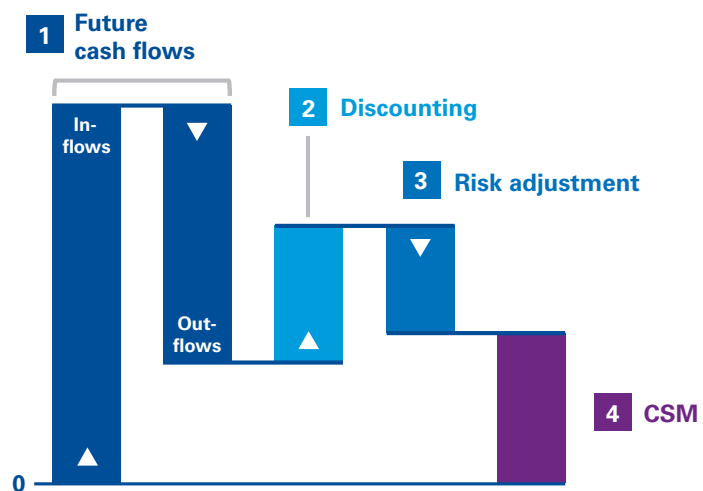
The liability (or asset) recognised for a group of insurance contracts is measured, on initial recognition and subsequently, as the sum of:

- the fulfilment cash flows, which are a risk-adjusted, explicit, unbiased and probability-weighted estimate of the present value of future 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 **future 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 future cash flows (to the extent that they are not already included in the estimates of future 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:

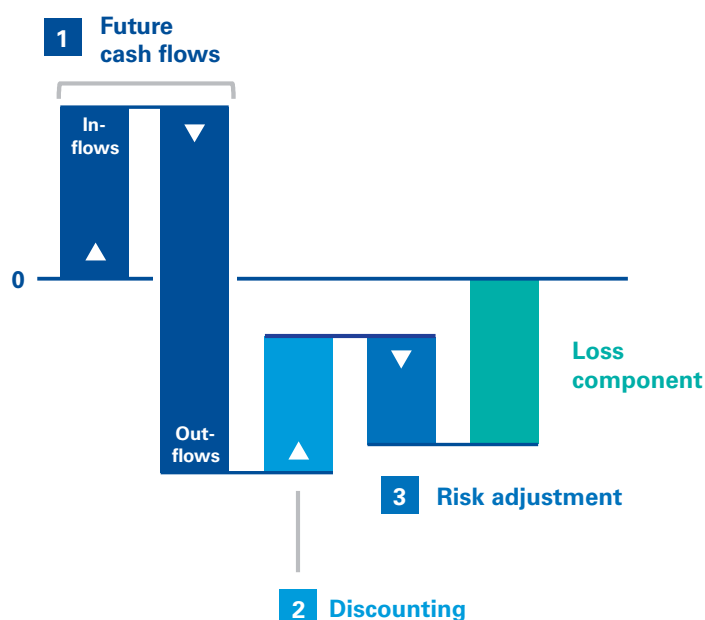
- the fulfilment cash flows;
 - the derecognition of any asset or liability recognised for insurance acquisition cash flows; and
 - any cash flows arising from the contracts in the group at that date,
- is a net cash inflow.

IFRS 17.47–49

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](#)).

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 on onerous groups. These amounts are not included in insurance revenue.



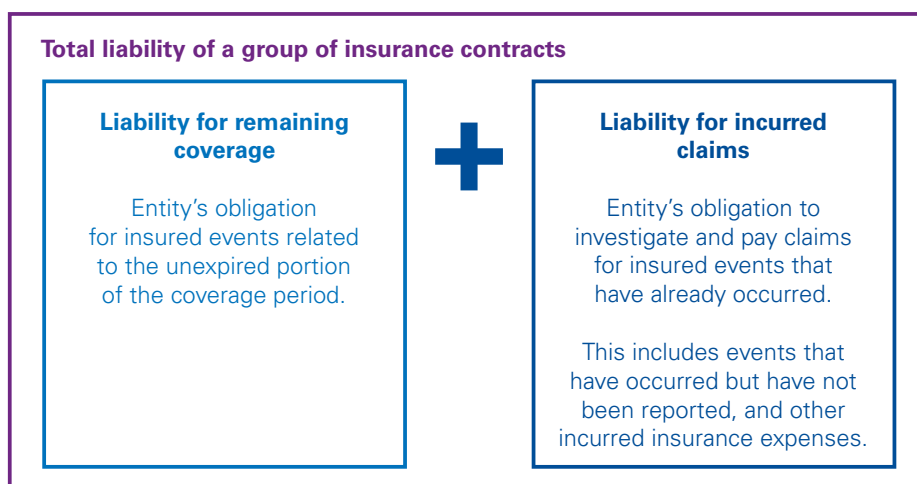
Note: Depending on the facts and circumstances, the size and direction of the components could vary.

5.3

IFRS 17.40, A, BC25

Subsequent measurement

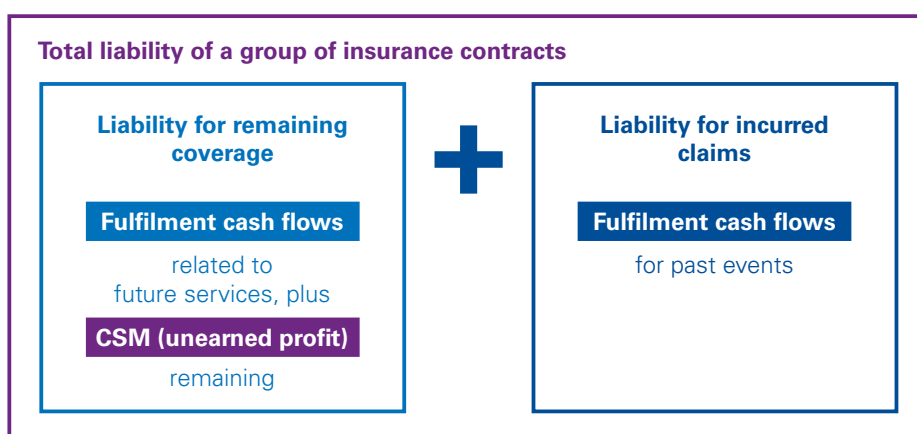
Subsequent to initial recognition, the total liability of a group of insurance contracts comprises the following.



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.



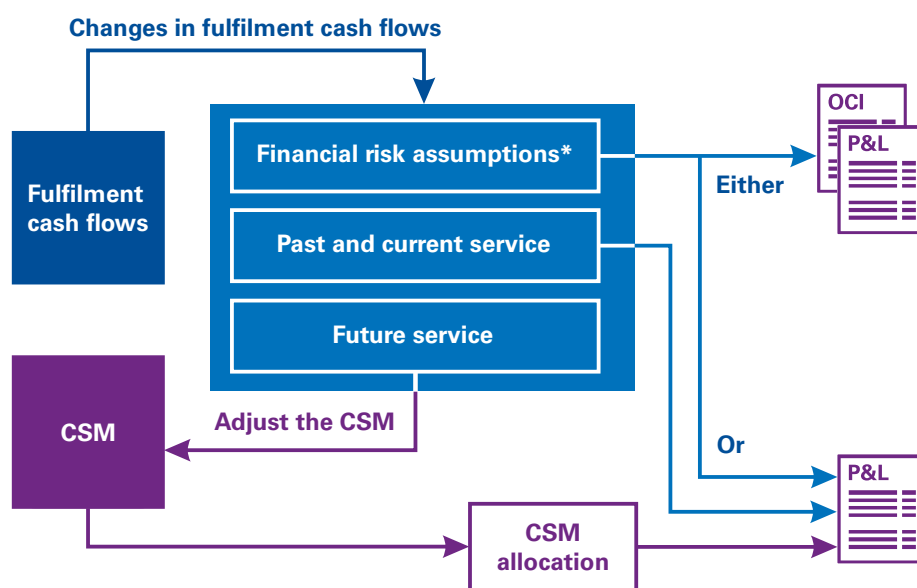
IFRS 17.43–44, BC22–BC24

The fulfilment cash flows are remeasured at each reporting date to reflect estimates based on current assumptions, applying the same requirements that apply on 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.

The CSM is also updated to reflect the unwinding of discounting for the time value of money. The balance is allocated to profit or loss each reporting period to reflect the provision of 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

All insurance 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:

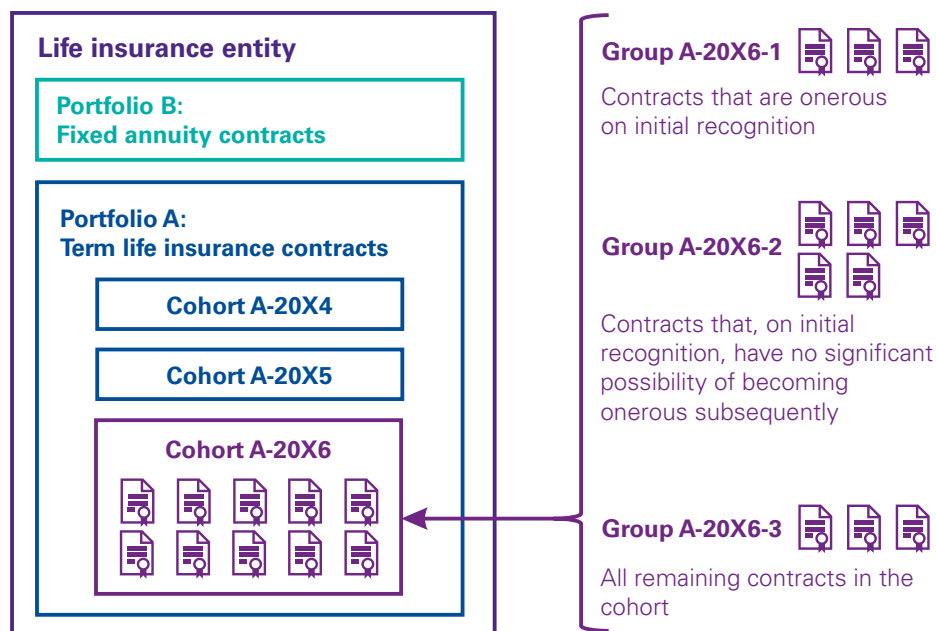
- a group of contracts that are onerous on initial recognition, if there are any (see [Chapter 11](#));
- a group of contracts that, on initial recognition, have no significant possibility of becoming onerous subsequently, if there are any; and
- a group of any remaining contracts in the portfolio.

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.



KPMG insight – 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.



KPMG insight – 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 a group (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.



KPMG insight – 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 future cash flows relating to future service before a claim is incurred would result in a CSM of zero.

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

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 law or regulation specifically constrains the entity's practical ability to set a different price or level of benefits for policyholders with different characteristics, 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.

IFRS 17.20

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



KPMG insight – 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.

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 comprises 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.



KPMG insight – 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.

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.



KPMG insight – 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.

IFRS 17.22, BC138

6.6.1

IFRS 17.22, 28

IFRS 17B73

IFRS 17.28

IFRS 17B137, BC236

Forming groups across reporting periods

When it is recognising a group of contracts in a reporting period, an entity includes only those contracts that have been issued by the reporting date. However, it may issue 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.

For the determination of the discount rate on initial recognition, entities are permitted to use weighted-average discount rates over the period during which contracts in the group are issued.

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.

If the entity publishes interim reports, it cannot change the treatment of accounting estimates made in previous interim financial statements when applying this standard in subsequent interim financial statements, or in the annual financial report.



KPMG insight – 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. 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 if they perform interim financial reporting, or measure and assess their performance based on quarterly groups.

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 or portfolio, 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.



KPMG insight – Interaction between the level of measurement and the level of estimate development

An entity is permitted to determine the expected present value of future 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 down to the group level, which may be more granular.



KPMG insight – 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 a portfolio level or 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.

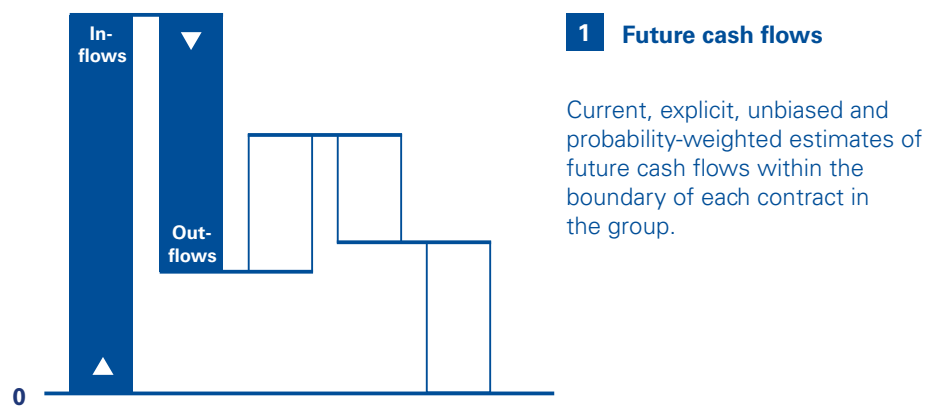
7

Future cash flows

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

7.1

Estimating future cash flows



IFRS 17.24, 33

IFRS 17 requires estimates of future 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 future cash flows in an unbiased way;
- include all the future 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 future 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 17B33, BC150

The requirement that estimates incorporate all reasonable and supportable information without undue cost or effort about the amount, timing and uncertainty of future 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 expected present value of future cash flows is 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:
 - a discount factor 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 future 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



KPMG insight – 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 address 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 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 a most likely or a more-likely-than-not outcome, 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

IFRS 17.33, B61

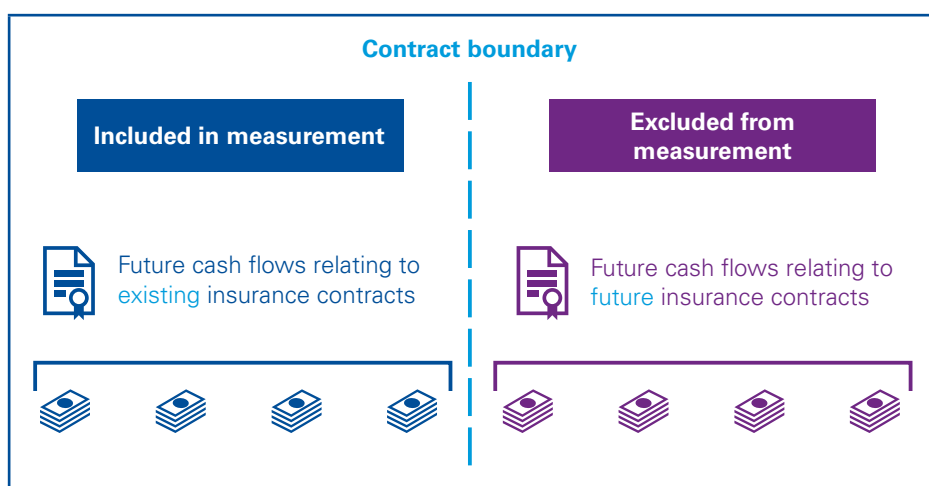
IFRS 17.35, BC164

The importance of the contract boundary

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

The contract boundary distinguishes the future 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 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 for coverage 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.



KPMG insight – 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 they bind the entity.

This assessment is made at each reporting date. Therefore, 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.



KPMG insight – 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.

Health insurance contracts

Health insurance contracts may permit an entity to reprice a contract on the basis of general market experience – e.g. morbidity experience – but not permit it 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 price for the contract that reflects overall changes in the risks in a portfolio of insurance contracts, it is considered to have the practical ability to set a price that fully reflects the risks in the contract from that date.

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

Cash flows	Examples
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

7.3.3

IFRS 17.B66

Cash flows that are outside the contract boundary

Cash flows that are not included in the estimates of future cash flows are as follows.

- Cash flows related to the following items (because they 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.
- 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 fall within the boundary of an insurance contract. They arise from selling, underwriting and starting a group of insurance contracts.

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.

IFRS 17.27

An entity recognises as an asset or liability any insurance acquisition cash flows relating to a group of insurance contracts that it pays or receives 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.

See also [Chapter 14](#) on the accounting policy choice available when the PAA is applied.



KPMG insight – 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 they meet the new requirements.

IFRS 17BC180, 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 does not require an asset recoverability test or the separation of acquisition cash flows between successful and unsuccessful efforts in obtaining new business.

Implications

This means that entities:

- continue to identify and measure acquisition cash flows; however, entities that treated these cash flows as separate assets from the insurance liability under IFRS 4 will no longer test the recoverability of these costs separately during the coverage period, or present them separately;
- that recognised acquisition cash flows as expenses when they were incurred need to adapt their systems to recognise these cash flows according to the relevant pattern for the related group of contracts; and
- that report under IFRS alongside other reporting frameworks may need to apply two different definitions and measurement approaches for acquisition cash flows going forward.

Entities may experience:

- larger losses at inception 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 inception 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 coverage has 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.

IFRS 17BC172

**KPMG insight – 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.

7.4

IFRS 17B41

Information used to make the estimates

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 17B41(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 17B41(d)

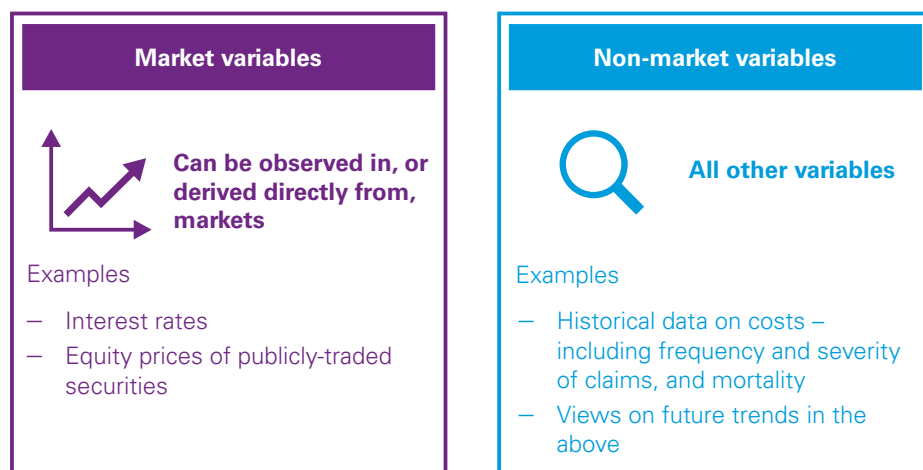
Current price information might be available to use as a basis for estimating future cash flows. For example, prices of:

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

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

IFRS 1733(b), B42

Estimates of future 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 interdependencies 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.

**KPMG insight – 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.

IFRS 17B50

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 future 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 17B60, 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 future cash flows only when they are substantively enacted.

IFRS 17B54–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, 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 a specific price change 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.



KPMG insight – 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 future 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 are necessary.



KPMG insight – 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 future 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 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 future 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.

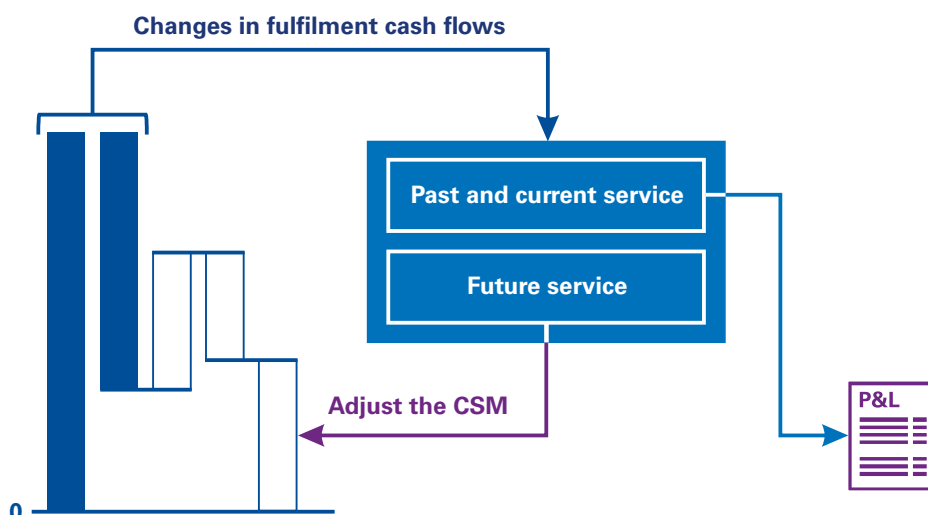
7.5

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

Using estimates of future cash flows in measurement

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

- *in the measurement of the fulfilment cash flows*: future 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 future cash flows that relate to future service. Other changes in the estimates of future cash flows are recognised in the statement(s) of financial performance (for further detail, see [Chapter 10](#)).

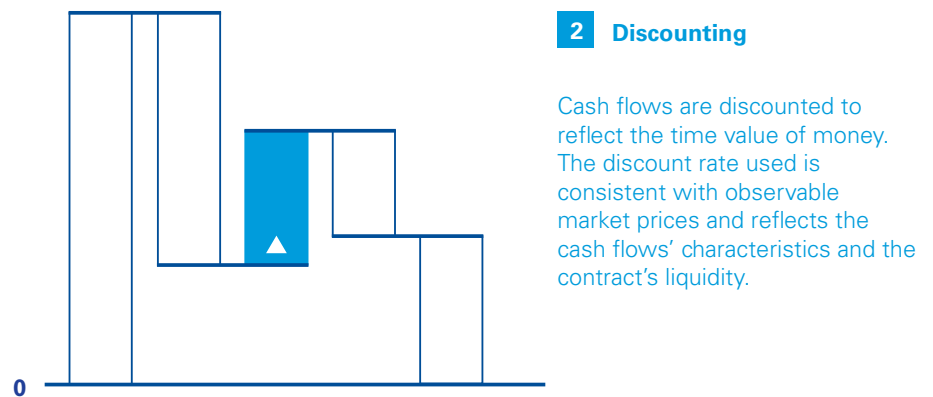


8

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 future 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 future 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 future cash flows of the insurance contract.



KPMG insight – 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 future cash flows are adjusted to reflect the financial risks associated with them. This can be achieved by adjusting the estimates of future 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 the way 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 future 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 have the ability 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;
- 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.



KPMG insight – 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, for example:

- discounting each cash flow scenario using a different discount rate; and
- 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, IFRS 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.



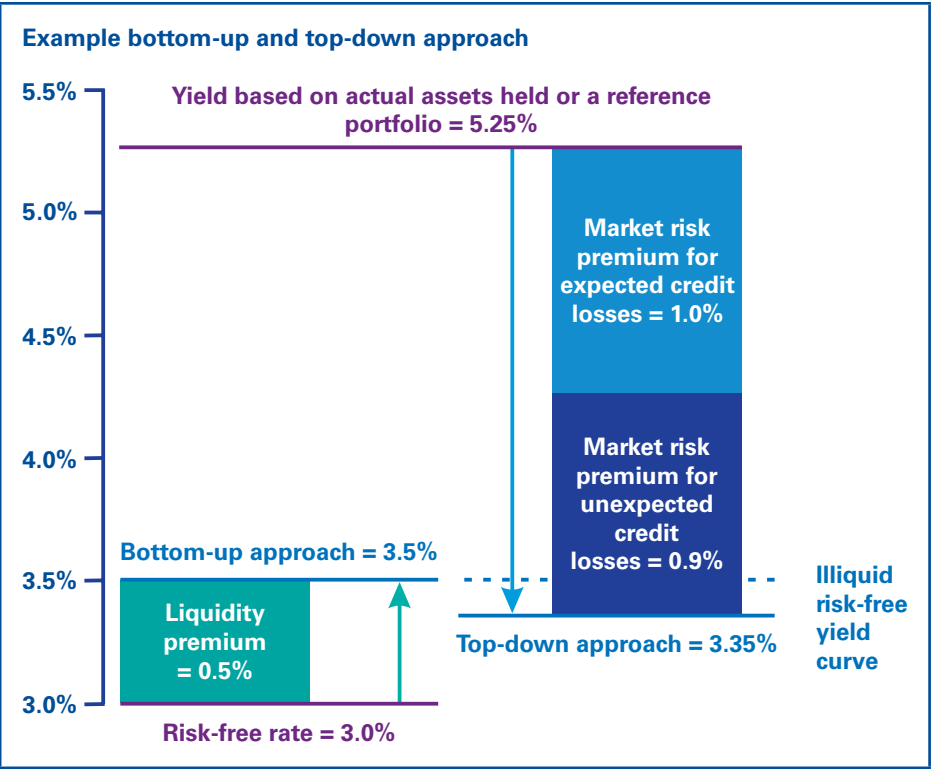
KPMG insight – Estimation techniques

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 17B80–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 17B79–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.



KPMG insight – 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 as 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.



KPMG insight – 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 if 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 the exercise of 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 17B81

IFRS 17B81

IFRS 17B85

IFRS 17B82

IFRS 17B83

IFRS 17B83, B85

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.

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

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.

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*.

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.



KPMG insight – 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 useful, but adjustments may be needed to reflect, for example, 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.



KPMG insight – 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 future 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 – e.g. 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 future 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.



KPMG insight – The ability to leverage 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 measurement 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 determine 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 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 flows*	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
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

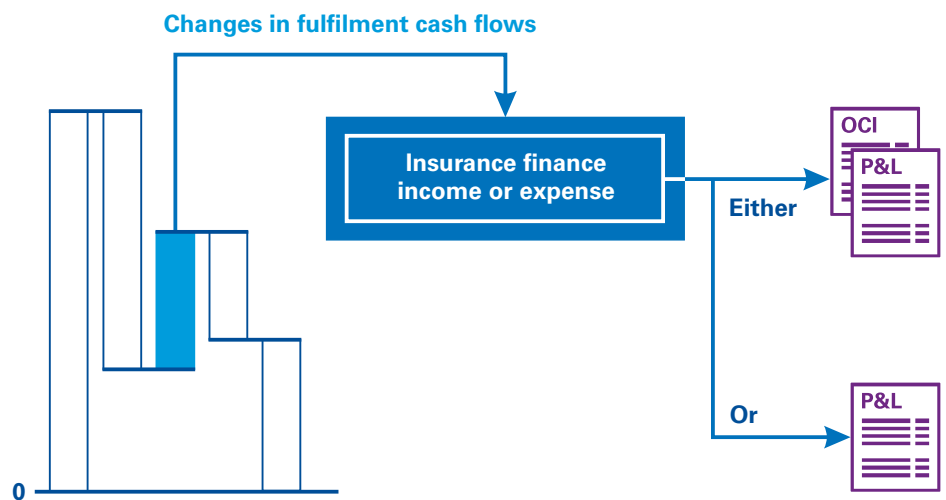
* Note: See Chapter 14 for information on how to adjust the fulfilment cash flows relating to incurred claims when the PAA is applied.

8.5

IFRS 17.87

Presentation of insurance finance income or expense

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



9

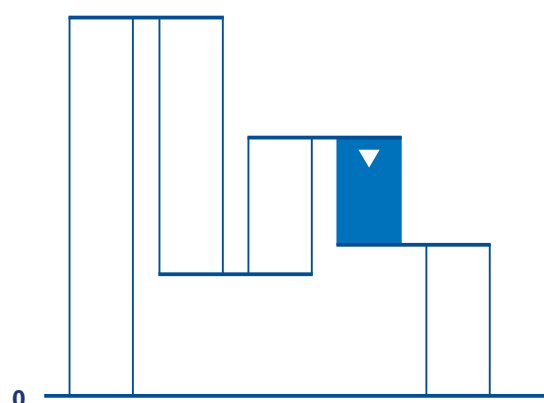
Risk adjustment

The third step in measuring a group of insurance contracts is to adjust the present value of future 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 charged 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

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 in either the estimates of future cash flows or in the discount rate, the risk adjustment for non-financial risk is explicit.

9.2

IFRS 17.B88

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 requires a measurement based on an exit price – e.g. fair value – rather than a fulfilment value.



KPMG insight – Entity's perspective

The techniques used in measuring the risk adjustment need to consider 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.

An entity is permitted to measure the risk adjustment for non-financial risk at different levels of its business – e.g. contract, portfolio, group of portfolios or entity level – 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.



KPMG insight – 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.

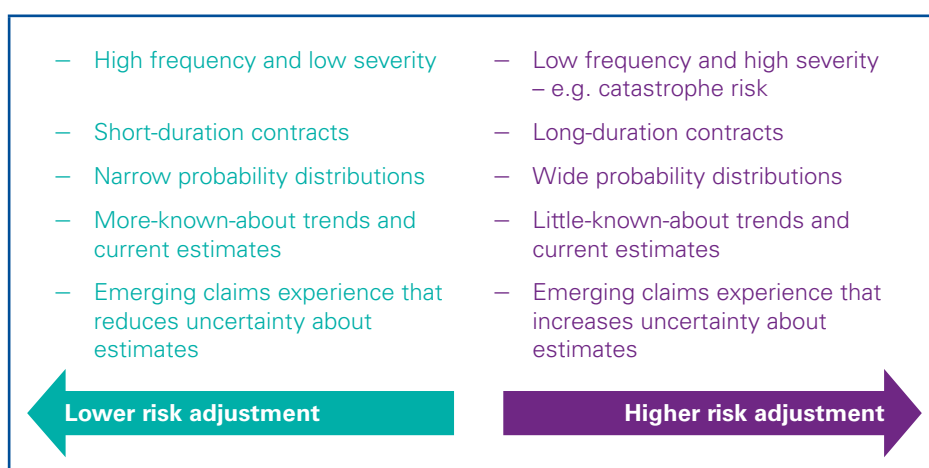
Therefore, an entity will have to allocate the risk adjustment for non-financial risk to each group of insurance contracts. Entities will also need to allocate changes in the risk adjustment for non-financial risk and determine the pattern of release from risk on subsequent measurement. No allocation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

9.3

IFRS 17B91

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 17B53

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 any non-financial risks that depend on market variables are consistent with observable market prices that depend on those market variables. For further discussion on market and non-market variables, see [Section 74](#).

IFRS 17B92

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.



KPMG insight – 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 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; and
- 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.



KPMG insight – 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 significant 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 close 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 future 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 ensure comparability across entities. This might have a significant impact on the choice of approach used and may be challenging for some entities to disclose.

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](#)).

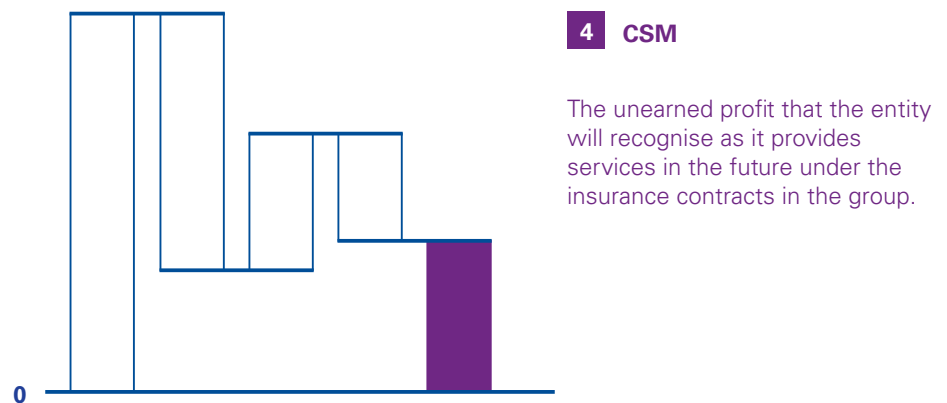
10

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



IFRS 17.27, 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 recognised for insurance acquisition cash flows²; 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

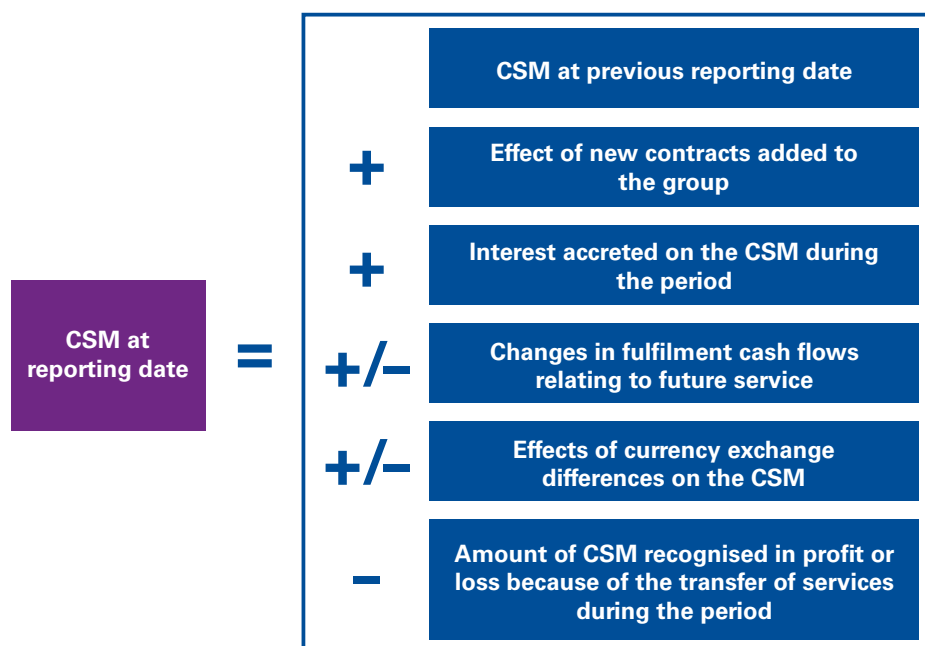
Generally, at each reporting date the carrying amount of a group of insurance contracts is remeasured by:

- updating the fulfilment cash flows using current assumptions; and
- updating the CSM to reflect changes in fulfilment cash flows related to future service, a financing effect and the profit earned as insurance services are

2. Any insurance acquisition 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. Once the group to which the insurance acquisition cash flows are allocated is recognised, the asset or liability related to those cash flows is derecognised, see [7.3.4](#).

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 service 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)

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. The discount rate is the one applicable 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](#).



KPMG insight – 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 likely.

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 future 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;
- changes in the risk adjustment for non-financial risk that relate to future service; and
- differences between the investment component expected to become payable in the period and the actual investment component that becomes payable in the period.

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 even if an insured event does not occur. IFRS 17 requires any unexpected repayment of an investment component to adjust the CSM. However, it 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 comprises only 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)

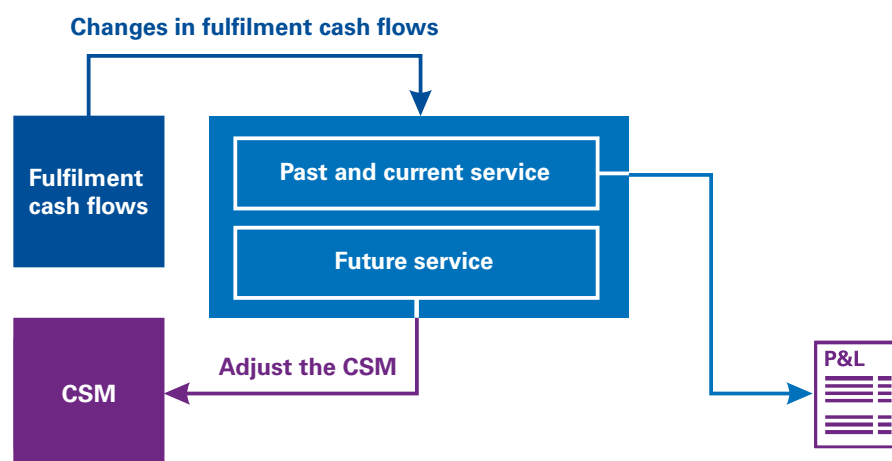
Changes in estimates of fulfilment cash flows in the liability for incurred claims relate to current or past services, so they do not adjust the CSM.

IFRS 17.BC233–BC234



KPMG insight – Experience adjustments and changes in the fulfilment cash flows relating to future service

The following illustrates IFRS 17's general principle for adjusting the insurance liability for changes in the fulfilment cash flows.



Changes in fulfilment cash flows that relate to future service adjust the CSM rather than being recognised immediately in the statement(s) of financial performance. In some cases, experience adjustments result in changes in the fulfilment cash flows that adjust the CSM as well.

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
Experience adjustment that impacts the actual cash flows in the current period	The experience adjustment is recognised in profit or loss because the change relates to current coverage.	Although the revenue based on expected benefit payments remains generally unchanged, the entity incurs lower than expected death benefit claims in the current period. The impact is recognised in profit or loss as claims are recognised.

Impact of actual vs expected mortality	IFRS 17 requirements	Explanation
Impact on fulfilment cash flows	This change adjusts the CSM because the change relates to future coverage.	<p>The future cash flows change to reflect the ongoing obligation to provide future service 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>This impact on the statement(s) of financial performance 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 the discretionary cash flows 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 these cash flows that are based on 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.

**KPMG insight – 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 those changes that relate 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.

**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 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.

IFRS 17:IE56

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 applying 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 adjusted in each reporting period for an amount recognised in profit or loss to reflect the 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 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 provided in the period.

IFRS 17.B119

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

IFRS 17.BC283

An entity recognises the CSM in profit or loss over the period for which it promised coverage under the contract, 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.



KPMG insight – 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 future 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 all other adjustments have been made to the carrying amount of the CSM.

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.



KPMG insight – 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.



KPMG insight – CSM tracking and allocation

Determining and tracking a 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.

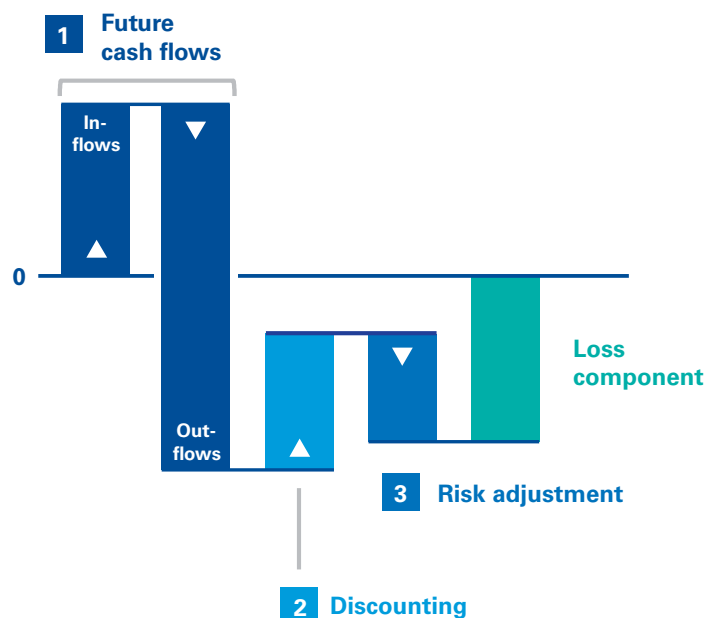
11

Onerous contracts

The fulfilment cash flows of a group of onerous contracts equates 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, the sum of the following results in a net cash outflow:

- the fulfilment cash flows; and
- any derecognised assets or liabilities for insurance acquisition cash flows allocated 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.

3. Any insurance acquisition 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. Once the group to which the insurance acquisition cash flows are allocated is recognised, the asset or liability related to those cash flows is derecognised, see 7.3.4.

11.2

IFRS 17.48(a), 49

Subsequent measurement

A group of contracts that has a CSM on initial recognition can become onerous (or more onerous) in subsequent periods, if unfavourable changes in the fulfilment cash flows arising from changes in estimates of future cash flows relating to future service exceed the carrying amount of the CSM. The excess is considered to be 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, certain, 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 future 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 future cash flows relating to future service 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.



KPMG insight – Systematic allocation of the loss component

IFRS 17 requires an entity to make a systematic allocation of certain 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.

IFRS 17.BC287, IE93

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

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

IFRS 17.75, BC306

IFRS 17.BC321, IFRS 9.3.3.1

IFRS 17.76

IFRS 17.77(a)

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.

An entity that purchases reinsurance – i.e. the cedant – derecognises the underlying (direct) insurance contracts only if they are extinguished by the reinsurance contract. Typically, entities do not derecognise insurance contracts when purchasing reinsurance contracts because the reinsurance contracts protect the entity from the losses on the underlying insurance contracts, but do not eliminate the entity's responsibility to fulfil its obligations under those contracts.

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

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

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 coverage to reflect the coverage units derecognised from the group (see [10.2.4](#)).

The accounting treatment differs when derecognition of an insurance contract is the result of the contract being transferred to a third party. In this 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.

**KPMG insight – Contracts derecognised from a group**

Contracts derecognised from a group of contracts, either because they lapsed or were transferred to a third party, 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.

For contracts transferred, the amount paid to a third party adjusts the CSM as well. 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 coverage to reflect the coverage units derecognised from the group (see [10.2.4](#)).

IFRS 17.77(b)

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



KPMG insight – Contracts derecognised from a group when they are modified

IFRS 17.BC319

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.

The amount that the entity would have charged the policyholder for the modified contract adjusts the CSM as well. 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.



KPMG insight – 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 17.27, 78–79, IAS 1.54

Statement of financial position

Groups of insurance contracts issued that are either assets or liabilities, and groups of reinsurance contracts held that are either assets or liabilities, are presented separately in the statement of financial position. These carrying amounts include any assets or liabilities for insurance acquisition cash flows paid or received before the group is recognised.

**KPMG insight – 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 are expected to be able to identify the position – i.e. asset or liability – of each group of contracts, in order to ensure the appropriate presentation.

Certain groups of contracts 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 and insurance acquisition costs etc.

Entities are expected to be able to associate insurance acquisition cash flows paid or received 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 group includes both the liability for remaining coverage and the liability for incurred claims. This means that entities will need to be able to identify whether the liability for incurred claims belongs to a group of insurance contracts that is an asset or to a group of contracts that is a liability, in order to apply the presentation requirements above. Systems that can track claims data based on the underwriting year could be helpful in this regard.

13.2

IFRS 1780, IAS 1.82

IFRS 1782, 86

IFRS 1785, BC357

IFRS 17BC34

IFRS 1741–42

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).

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 as separate amounts recovered from the reinsurer and an allocation of the premiums paid (see Chapter 17).

Insurance revenue and insurance service expenses presented in profit or loss exclude any investment components. Even though premiums charged may contain investment components, these investment components do not represent consideration for providing services and are not included in the 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.



KPMG insight – 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. An example of an investment component is an amount included in incurred claims that the contract requires to be repaid even if no insured event occurs, or a no-claims bonus included in premiums that is repaid if no claims occur.

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

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–B124

Liability for remaining coverage ¹			
	Insurance revenue	Insurance finance income or expense	Explanation
Opening balance			
Insurance service expenses incurred during the period at the amount expected at the beginning of the period²	✓		
Changes to risk adjustment for non-financial risk that do not relate to future service	✓		However, 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 is a notional entry that does not impact the liability for remaining coverage
Effect of the time value of money and financial risk – impact on fulfilment cash flows		✓	
Effect of the time value of money – impact on the CSM		✓	

IFRS 17.41–42, B120–B124

Liability for remaining coverage ¹			
	Insurance revenue	Insurance finance income or expense	Explanation
Changes in fulfilment cash flows for non-financial risk assumptions related to future service		✓	CSM adjustments are measured at the discount rate on initial recognition, and fulfilment cash flows adjustments are measured at current rates. Any resulting difference is included as insurance finance income or expense
Premiums received			These increase the liability – they are not the revenue for a period
Insurance acquisition cash flows			These reduce the liability
Closing balance			
Notes <ol style="list-style-type: none"> 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. 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	✓		

Liability for incurred claims			
	Insurance service expenses	Insurance finance income or expense	Explanation
Changes in risk adjustment for non-financial risk	✓		However, 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

13.2.1.1

IFRS 17.B123

Insurance revenue

Generally, the total insurance revenue for a group of insurance contracts over their duration is the amount of policyholders' 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.

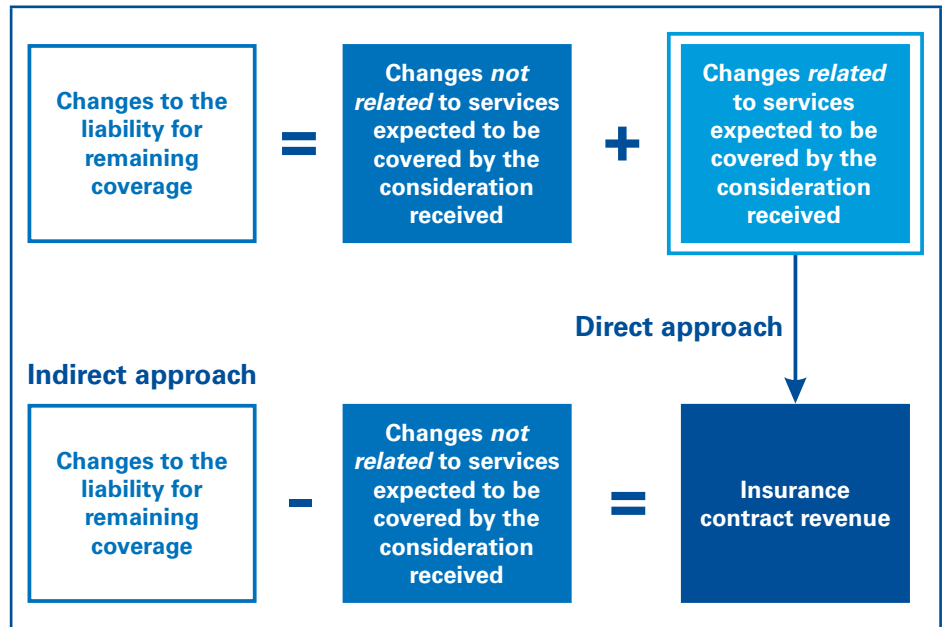
Insurance revenue depicts the provision of coverage and other services arising from the group of insurance contracts at an amount that reflects the consideration to which an entity expects to be entitled in exchange for those services. This amount comprises:

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

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 17B121(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 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; and
 - the amortisation of insurance acquisition cash flows;
- 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; and
- the amount of the CSM recognised in profit or loss in the period.

13.2.1.3

IFRS 17B123

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;

- 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 eventually 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, the revenue and the expenses are not recognised when the acquisition cash flows occur, but are separately identified and recognised over the coverage period.

13.2.2

IFRS 17.84–85

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.



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.

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.

IFRS 17.IE4–IE29, IE81–IE98

	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) ^(a)	(260)	(130)	-
Insurance contract liability	-	(1,050)	(700)	(350)	-
Note a. $520 - 520 / 4 = 390$. 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 duration. 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 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)	(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^(b)	350	350	350
Revenue to cover acquisition cash flows	25 ^(d)	25	25	25
Insurance revenue	375	375	375	375
Service expenses	200	200 ^(c)	200	200
Insurance acquisition expenses	25 ^(d)	25	25	25
Insurance service expenses	225	225	225	225
Insurance service result	150	150	150	150
Notes				
b. 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.				
c. 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.				
d. $100 / 4 = 25$. 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.				

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 includes 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)	-(e)	-
Insurance contract liability	-	(1,050)	(700)	(570)	-
Note					
e. 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 ^(g)
Risk adjustment recognised not allocated to loss component	20	20	20	17 ^(g)
CSM allocation	130	130	-	-
Loss component	-	-	(90)	90
Closing balance	(1,050)	(700)	(570)^(f)	-

Notes

- f. 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.
- g. 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	480^(h)
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⁽ⁱ⁾
Notes				
h. 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.				
i. This is effectively the risk adjustment released (17 recognised as insurance revenue and 3 recognised as a reduction in insurance service expenses).				



KPMG insight – 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 is expected to result in significantly different amounts of revenue being recognised as that recognised under current practice 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.



KPMG insight – 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 in order 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 flows 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 17.87(c), BC246–BC247

However, for direct participating contracts the entity's share of the change in the fair 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 its accounting policy, to present the insurance finance income or expense:

- in profit or loss; or
- disaggregated between profit or loss and OCI (the disaggregation policy choice).

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 17.129, IAS 8.13

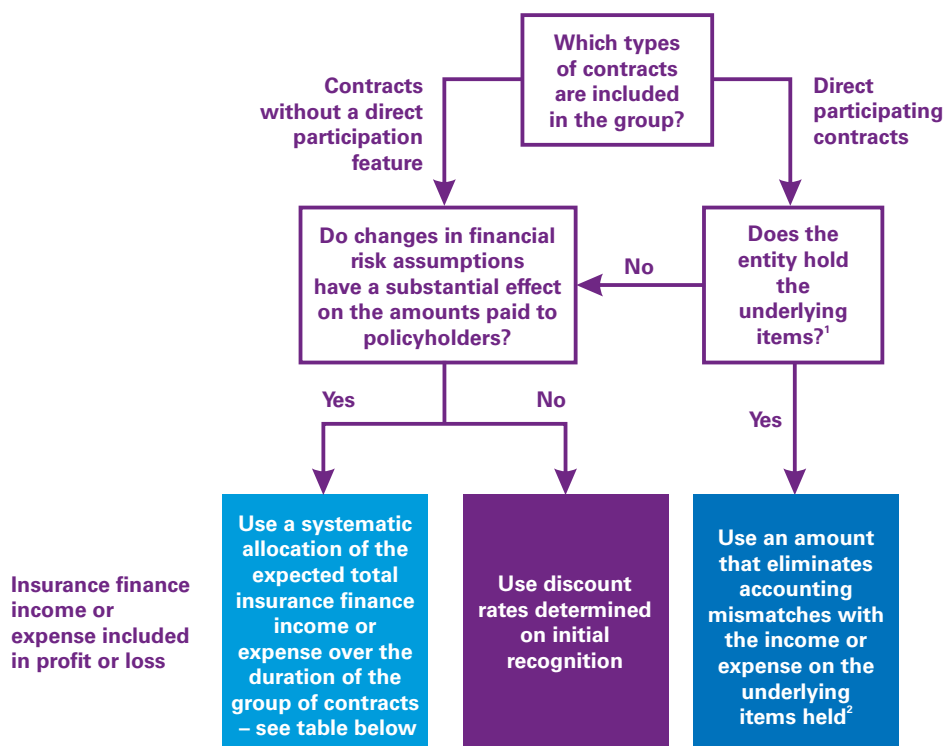
Under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, an entity selects and applies consistent accounting policies for similar portfolios of insurance contracts. In assessing whether portfolios of insurance contracts are similar, the entity considers for each portfolio the assets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

IFRS 17.88–90

When an entity applies the disaggregation policy choice, 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. The following table illustrates how the amount of insurance finance income or expense that is presented in profit or loss is determined.

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 this policy choice is applied.

IFRS 1788–89, 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).	
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 the old disaggregation policy choice up to the date of the change, reclassifies the amount accumulated in OCI to profit or loss as a reclassification adjustment, and then applies the new disaggregation policy choice prospectively without restating prior-period comparatives.

IFRS 17B134

2. 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 17.91(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 17.88(b), B130

3. 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. Additionally, this allocation results in the amounts accumulated in OCI over the duration of the groups of contracts totalling zero.

IFRS 17.91(a)

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

IFRS 17B132(b)

4. 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 17.30, 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 future 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 is determined 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 disaggregation policy choice.



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 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) ^(a)	(691)	(754) ^(b)	(777)	-
Fulfilment cash flows	342	(691)	(754)	(777)	-
CSM	(342)	(269)	(188)	(98)	-
Insurance contract liability	-	(960)	(942)	(875)	-
Notes					
a. $800 / 1.05^4 = 658$.					
b. $800 / 1.03^2 = 754$.					

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 ^(c)	13	9	5
Release to profit or loss	(90) ^(d)	(94)	(99)	(103)
Closing balance	269	188	98	-
Notes				
c. $342 \times 0.05 = 17$. The same interest rate is used for the subsequent periods.				
d. $(342 + 17) / 4 = 90$.				

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) ^(e)	(48) ^(f)	(46) ^(h)	(43)
Insurance finance income/ (expense) in OCI	-	(28) ^(g)	14 ⁽ⁱ⁾	15
Expected claims	-	-	-	800
CSM allocation	90	94	99	103
Closing balance	(960)	(942)	(875)	-

Notes

- e. An expense of 50 comprises the time value of money for the fulfilment cash flows of (658×0.05) and for the CSM of 17.
- f. An expense of 48 comprises the time value of money for the fulfilment cash flows of (691×0.05) and for the CSM of 13.
- g. 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 future cash flows (754) and the corresponding amount at the end of Year 1 (691), plus interest on the CSM (13).
- h. An 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.
- i. 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.



KPMG insight – Disaggregating insurance finance income or expense: New operational complexities

When applying the disaggregation policy choice, 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 investment expense accreted on the CSM, and to determine the amount by which the CSM is adjusted when there are changes in the estimates of future cash flows related to future service.



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

When determining whether to apply the disaggregation policy choice, entities will probably want to consider the expected accounting mismatches that may arise and the potential ways to mitigate them.

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 as 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 disaggregation policy choice, 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.

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 disaggregation policy choice, 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 17B124(b)

Disaggregating changes in the risk adjustment for non-financial risk

Generally, insurance revenue recognised in a reporting period includes the changes in 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 1781

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 it 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 17B124(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 – might still face new challenges when applying IFRS 17.

14.1

IFRS 17.40, A

A simplified model

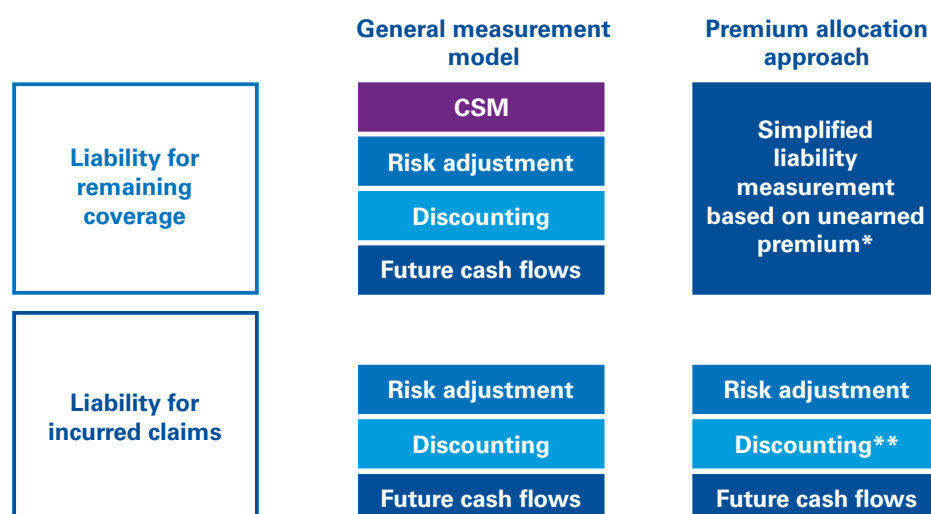
As outlined in [Section 5.2](#), the total carrying amount of a group of insurance contracts is made up of:

- 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 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:

* Unless the group of contracts is onerous. See further discussion at [14.3.2](#).

** Unless the entity is permitted and chooses not to adjust the future cash flows for the time value of money. See [Section 14.4](#).



KPMG insight – 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, some of 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:

- 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 disaggregation policy choice for the liability for incurred claims and the liability for remaining coverage (see [Section 14.4](#) and [14.3.4](#)).

14.2

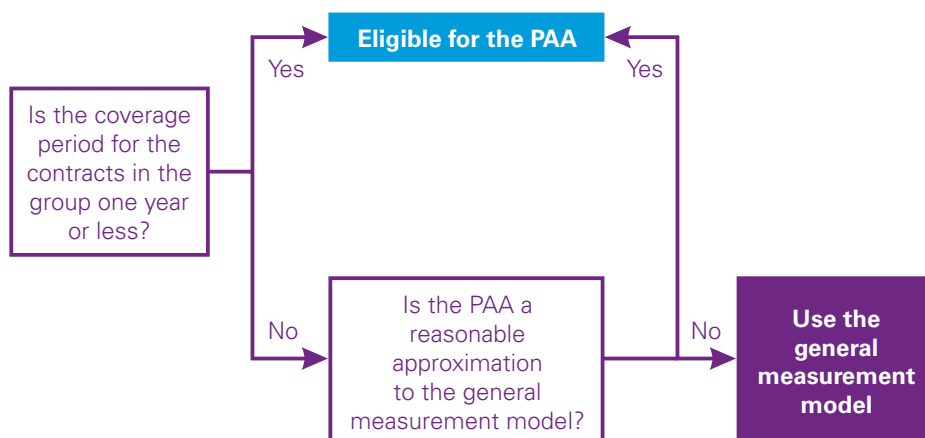
IFRS 17.53

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 coverage arising from all premiums within the contract boundary.



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



KPMG insight – Sensitivity of the PAA to changes in estimates

Under the general measurement model, estimates of expected future 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.

The PAA does not treat estimates of expected future cash flows in the same way and, therefore, unless the contract becomes onerous, the profitability and contract measurement in a reporting period that is reported during the coverage period is not generally affected by changes in estimates relating to future reporting periods.

Therefore, the PAA may provide a reasonable approximation of the liability for remaining coverage under the general measurement model when the contract is not expected to have significant variability in its fulfilment cash flows during the period before a claim is incurred.

This is deemed to be the case for contracts with 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 reasonable approximation of 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. Entities may be able to leverage some of the information used in contract pricing, since this pricing 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 establishing a measurement of the margin and determining an acceptable margin that results in a 'reasonable approximation'. Entities are also expected to apply judgement over how often to refresh the analysis for the purpose 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.



KPMG insight – Assessing eligibility for the PAA

General insurance contracts

Contracts with a coverage period of one year or less automatically meet the PAA eligibility criteria, even if the claims settlement period is greater than the coverage period. 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 of 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 because, in many jurisdictions, a similar unearned premium approach is currently applied.

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. However, contract boundaries require consideration (see 7.3.1).

Many life contracts will probably not meet the PAA eligibility criteria, because their coverage periods are significantly greater than one year. Therefore, life insurance products will probably be accounted for under the general measurement model, even if some of them meet the PAA eligibility criteria, mainly because it is expected that the contracts will be handled using similar processes and systems.

14.3

IFRS 17.55(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) as:

$$\boxed{\text{Liability for remaining coverage}} = \boxed{\text{Premiums received}} - \boxed{\text{Acquisition cash flows}^*}$$

* Note: Unless the entity chooses – when applicable – to recognise insurance acquisition cash flows as expenses as they are incurred (see 14.3.1).

IFRS 17.57, BC289

The initial measurement does not explicitly identify the present value of future 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 certain simplifications if certain conditions are met (see 14.3.2).

14.3.1

IFRS 17.55(a), B125

IFRS 17.59(a)

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.

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).



KPMG insight – 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 are a reasonable approximation of 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 as their systems and processes may not need significant adjustment. However, they will still have to assess whether the costs previously deferred meet the definition of insurance acquisition cash flows under IFRS 17.

Other entities may consider recognising those 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 1757–58

IFRS 1757–58

IFRS 1757

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 by applying 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 need 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 future cash flows for the time value of money and the effect of financial risk, it determines the discount rate consistently with the requirements for the general measurement model (see [Chapter 8](#)).



KPMG insight – When does an entity assess whether a contract is onerous?

Entities are not required to perform a periodic measurement exercise to assess whether all 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 if 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 the insurance obligations.



KPMG insight – Onerous contract measurement: Potentially significant changes in practice

The accounting for onerous contracts under the PAA might involve a significant change in current practice, even if a similar method of accounting is used under IFRS 4 to measure the liability for remaining coverage.

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 certain simplifications 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 future 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 future cash flows calculation is required to calculate the loss on an onerous contract. This requires estimating the expected future 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.



KPMG insight – 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.



KPMG insight – 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 currently account for their business at similar aggregation levels by offsetting expectations for gains and losses on contracts within the same group. Based on this level of aggregation, 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 appropriate 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.

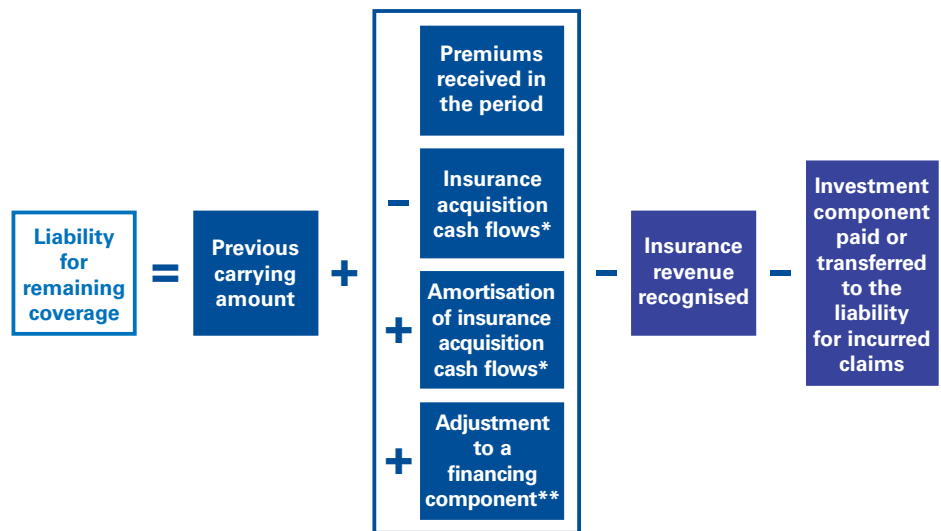
Given the inherent asymmetry between recognising losses immediately in profit or loss and deferring gains, it is critical that entities assess the effect that this may have on their financial reporting and on the information used to manage the business.

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:

* Unless the entity chooses to recognise the insurance acquisition cash flows as expenses as they are incurred, when applicable.

** 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 coverage 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 are changed 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 using a discount rate determined on initial recognition and the effect of financial risk.

However, if on initial recognition, the entity expects the time between providing each part of the coverage 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.

IFRS 17/E13

**Example 11 – Revenue recognition under the PAA**

Entity E issues insurance contracts on 30 June 2021 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 for the effect of the time value of money.

E's annual reporting date is 31 December, at which 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.

31 December 2021

The effect of 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 financial performance for the six months ended 31 December 2021

Insurance contract revenue	615
Insurance finance expense	(30)
Profit	585

Facts and circumstances changed since inception

At 31 December 2021, facts and circumstances indicate that the group of contracts is onerous. E calculates the fulfilment cash flows applying 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 of 800 and a loss of 185 that is recognised in profit or loss on 31 December 2021.



KPMG insight – 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; 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 automatically to meet the simplification option eligibility requirements 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 also 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.

Implications for consideration

Under the PAA, reflecting the time value of money 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 will need to ensure that their systems and processes are capable of tracking the 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. This will be a more significant cost and concern for entities that do not currently accrete interest for their business.
- As many premiums are received at the beginning of the coverage period, the profit (underwriting and financial results) in the beginning of the coverage period is lower than it would have been without accounting for the effect of the time value of money. 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. This is because 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. 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.



KPMG insight – 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.



KPMG insight – Insurance contract revenue: Change in practice

Similar to the general measurement model, the PAA could 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 presentation of insurance contract revenue represents the insurance contract revenue recognised over the reporting period. 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 premiums receivables and pipeline premiums. Instead, the liability for remaining coverage represents the net contract position (asset or liability) for future coverage.

Additionally, investment components are not included in the insurance revenue and insurance service expenses. For the general insurance industry, which is expected to apply the PAA for most of its contracts, 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 is an example of an investment component that is excluded from insurance revenue and insurance service expenses.

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 future 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 future 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 disaggregation policy choice (see [Chapter 15](#)), 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, the insurance acquisition cash flows are deferred, and the discounting of future 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:

$$24 / 12 = 2$$

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 direct 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)
Claims incurred	(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 reduce 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; and
- measuring an explicit risk adjustment for non-financial risk.

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 future 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. The underlying items can comprise any items as long as they are clearly identified by the contract.

When these services are substantial, the contract meets the definition of a direct participating contract and so the accounting reflects the notion that changes in the investment-related fees are considered to relate to future service. When a contract meets the requirements to be defined as a direct participating contract, it applies the modifications to the general measurement model discussed throughout this chapter. This approach is called the 'variable fee approach', because the CSM is adjusted to reflect the variable nature of the fee.

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 section.

	General measurement model	Variable fee approach
Changes in the fulfilment cash flows arising from time value of money and financial risks	Recognised immediately in the statement(s) of financial performance as insurance finance income or expense	Regarded as part of the variability of the fee for future service and recognised in the CSM*
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: Unless either the changes exceed the amount of the CSM, or the entity applies the risk mitigation option for not adjusting the CSM

This section describes what a direct participating contract is 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 17.B104, 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.

Obligation to pay policyholder	=	Obligation to pay fair value of underlying items	–	Variable fee
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IFRS 17.B101

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 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.



KPMG insight – 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. These requirements are consistent with those in IFRS 15 and are 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.

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.

IFRS 17.2, B105, BC69

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 percentage 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.

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.



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 fixed 3% annual rate. 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.

IFRS 17.B106

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 management services 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 group of insurance contracts and on a present value, probability-weighted average basis.



KPMG insight – 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 the 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.



KPMG insight – 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 policyholders' share of the fair value returns on underlying items and the lower levels of minimum guarantees. However, for other types of contracts, meeting the criteria might not be as likely.

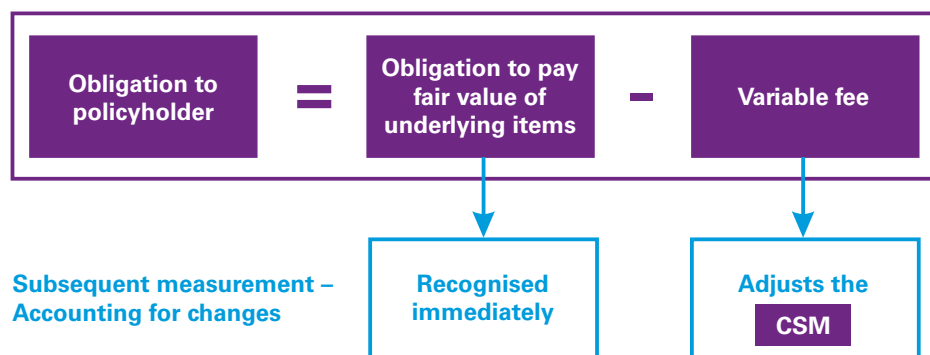
Investment contracts with DPFs

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. As for subsequent measurement, differences arise within the treatment of the CSM, which includes specific modifications that reflect the specific nature of direct participating contracts.

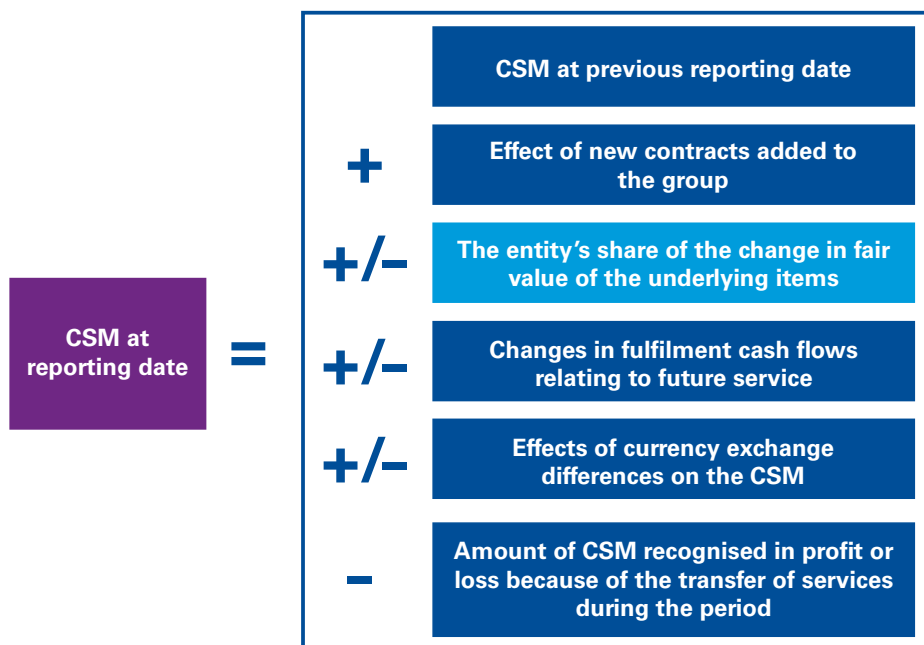


IFRS 17B101, B107(b)

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

The entity's share of the change in the fair value of the underlying items

IFRS 17.45(b), B111, B112, B115, BC243, BC247

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 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 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 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

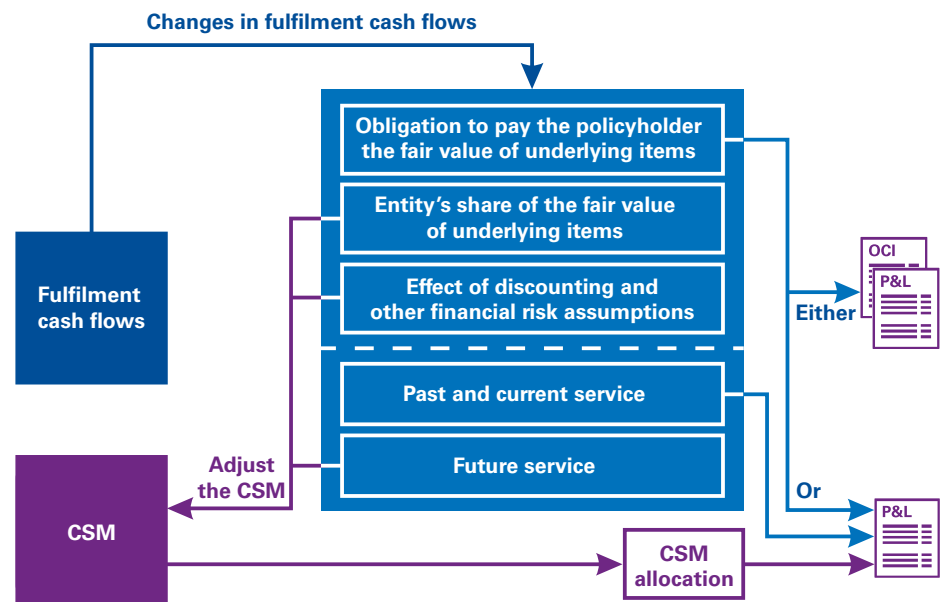
The CSM is adjusted for changes in fulfilment cash flows relating to future service. These include:

- 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 disaggregation policy choice. 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) ^(a)
Risk adjustment	(25)
Fulfilment cash flows	795
CSM	(795)
Insurance contract liability	-
Note a. 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.	

At the end of Year 1, X determines the fair value of the underlying items as follows.

	Year 1
Opening balance	-
Premiums received	15,000
Investment return	1,500 ^(b)
Annual charge	(330) ^(c)
Payments for death	(162) ^(d)
Closing balance	16,008
Notes b. The investment return is derived as the beginning balance multiplied by the investment return in the period (15,000 x 0.10). c. 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]. d. 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)].	

At the end of Year 1, the movement of the liability is as follows.

	Estimates of the present value of future 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 ^(e)			170
Change in the fair value of underlying items	(1,500)			(1,500)
X's share of the change in the fair value of the underlying items	30 ^(f)		(30)	-
Effect of the time value of money and other financial risks	67 ^(g)		(67)	-
Allocation to the statement(s) of financial performance		12	300 ^(h)	312
Closing balance	(15,413)	(13)	(592)	(16,018)

Notes

- e. 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.
- f. X's obligation to the policyholder (1,500) is adjusted for X's share of the change in the fair value of the underlying items, which adjusts the CSM (1,500 x 0.02). This is not required to be specifically identified.
- g. 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.
- Rather, the total CSM adjustment can be 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. The difference (97) is the sum of X's share of the change in the fair value of the underlying items (30) and the effect of the time value of money and other financial risks (67).
- h. 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.

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⁽ⁱ⁾
Insurance service expenses	8 ^(j)
Insurance service result	312
Investment income	1,500
Insurance finance expenses	(1,500) ^(k)
Finance result	-
Profit	312
Notes	
<p>i. 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.</p> <p>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).</p> <p>j. Insurance service expenses includes the amounts payable to the policyholder (170) less the investment component paid from the policyholder's account balance (162).</p> <p>k. 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.</p>	



KPMG insight – 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 – these 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.
- Generally, changes in the time value of money and all financial risks adjust the CSM. So, the volatility of reported profits that may currently result from 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, profit or loss for groups of contracts impacted by these changes is not as positively correlated with volatility in financial markets as under some current accounting models or the unmodified 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.



KPMG insight – 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 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, entities have less experience with performing it on an ongoing basis as part of their financial reporting process.

15.3.3

IFRS 17BC250, 252

Financial risk mitigation using derivatives

Derivatives used to mitigate financial risks arising from insurance contracts are generally measured under IFRS 9 at FVTPL. An example is interest rate options used to mitigate interest rate risk arising from guarantees embedded in insurance contracts. For direct participating contracts, changes in the effect of financial risks associated with the measurement of insurance contracts relate to future service and, therefore, adjust the CSM instead of being recognised immediately in the statement(s) of financial performance, regardless of whether they relate to the entity's share of the underlying items.

When comparing the measurement of the derivative and the insurance liability, an accounting mismatch could result because the impact of changes in financial risks on the fair value of the derivative is recognised in profit or loss, whereas the mitigated financial risk arising from the insurance contracts adjusts the CSM. IFRS 17 provides an option to help reduce such accounting mismatches for direct participating contracts.

IFRS 17B113, B115–B116

An entity may choose to exclude from the CSM some or all of the effect of financial risk on the entity's share of the underlying items or changes in the effect of the time value of money and financial risks not arising from the underlying items when meeting the following criteria:

- it uses a derivative to mitigate financial risks arising from the insurance contracts – e.g. the effect of financial guarantees;
- it applies a previously documented risk management objective and strategy for using derivatives to mitigate financial risk arising from the insurance contracts;
- an economic offset exists between the insurance contracts and the derivative; and
- credit risk does not dominate the economic offset.

IFRS 17B117

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 17B118

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 17.BC251–BC252


KPMG insight – 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 effect of financial risks are considered not to relate to future service and so do not adjust the CSM. These changes are recognised immediately in the statement of financial performance. As previously mentioned, derivatives used to mitigate financial risks arising from insurance contracts are generally measured under IFRS 9 at FVTPL. 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 derivative 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 between the recognition of the change in the value of the derivative and the recognition of the change in the carrying amount of the insurance contract related to the financial risks that the derivative is intended to mitigate. However, an accounting mismatch due to the measurement principles may still result. For example, this could be because the value of the derivative is probably measured at FVTPL, whereas the change in the carrying amount of the insurance contract related to the financial risks that the derivative is intended to mitigate is measured based on the current fulfilment value under the general measurement requirements.

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 them should take into consideration these risk mitigation activities when determining whether to apply the disaggregation policy choice.

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, IAS 28.18–19, IAS 32.33A,
IAS 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 is the fair value option applicable?	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 corporate bonds – as underlying items for a group of direct participating contracts or as investment funds, 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 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 9.3.3.5, IFRS 7.8(a), 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.



KPMG insight – 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 unmodified 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 unmodified 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 – i.e. the pattern of provision of investment-related services (for the unmodified requirements, see Chapter 10).

All other requirements of the standard apply, unmodified to investment contracts with DPFs.

IFRS 17.BC65(a), BC83, IFRS 4.34–35



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 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 not many entities issue these types of contracts and do not 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, when 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



KPMG insight – 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 changes in their fair value to be a substantial portion of changes in the amounts paid to the policyholder.

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 identifying the difference between the effect of changes in financial risk assumptions relating to its contractual commitment (do not adjust the CSM) and those 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-related services is likely to reflect the entity's expectation of the amount of funds to be managed throughout the contract boundaries, if 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 to reinsurance contracts held. It should be read with [Chapters 5–12](#), which outline the general measurement model.

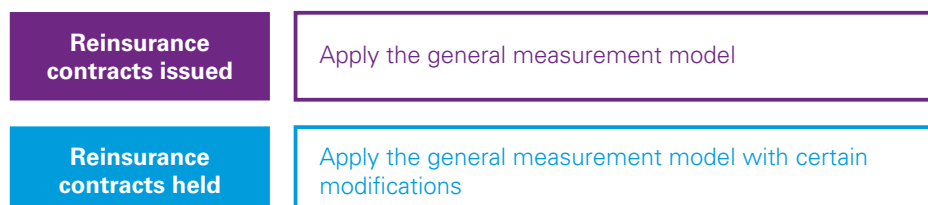
17.2

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.

Applying the general measurement model to reinsurance contracts



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 a 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 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. The cedant has 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. Therefore, an entity cannot apply the modifications described in [Chapter 15](#) to groups of 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

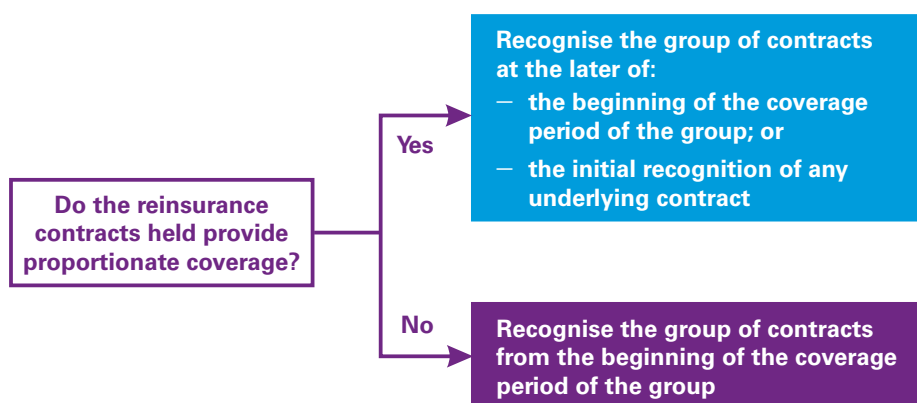
An entity applies the aggregation requirements to divide portfolios of reinsurance contracts into groups, adapted to reflect the features of reinsurance contracts held (see [Chapter 6](#)). Applying these requirements could result in groups that comprise a single contract.

17.3

Recognition

IFRS 17.62

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.BC305(b)

If the group of reinsurance contracts held covers the aggregated losses from a group of underlying contracts that exceed a specified amount, then the entity benefits from coverage – in case 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.



KPMG insight – 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.

For excess of loss reinsurance contracts, initial recognition can differ from that for the underlying insurance contracts. The boundaries of these types of contracts can differ, as well. This can result in circumstances in which the PAA eligibility conclusion could be different for the reinsurance contracts held and the 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 should be performed, taking 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.

Practical implications

The contractual terms of reinsurance contracts should be assessed to determine whether they cover losses on a proportionate basis, because this might impact their initial recognition.

In some cases, the terminology used in the contract may seem to suggest that the reinsurance contract provides proportionate coverage. However, analysis of the contractual terms relating to reinsurance commission might lead to the conclusion that this is not the case. For example, if the commission is based on an aggregated outcome of the underlying insurance contracts, then it might be that the reinsurance coverage does not effectively cover a certain percentage of each claim from the underlying contracts.

17.4

IFRS 1763, BC300

IFRS 1763, BC307–BC308

Estimating future cash flows

An entity uses consistent assumptions to measure the estimates of the present value of the future cash flows for the group of reinsurance contracts held and the estimates of the present value of the future 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 future 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 future cash flows, see [Chapter 7](#).

17.5

IFRS 1764

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 1765

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:

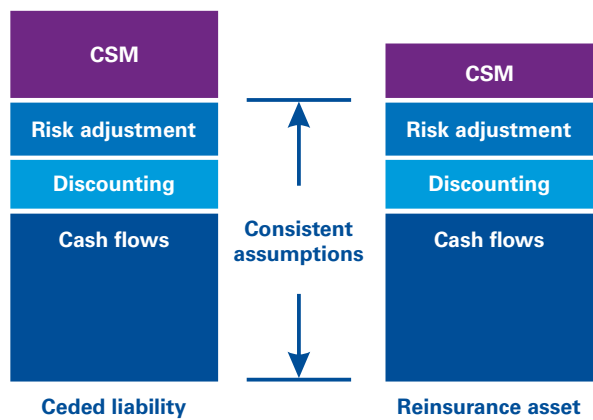
- if the coverage of the group of reinsurance contracts relates to events that occurred before the purchase of the group – e.g. coverage against an adverse development of claims incurred – any net cost of purchasing reinsurance coverage is recognised immediately in profit or loss as an expense; and
- 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; and
 - any cash flows arising from the contracts in the group at the date of initial recognition of the group.

IFRS 17BC310–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 if they are overstated.



Example 15 – Reinsurance contracts held: Measurement on initial recognition

Example 15.1

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, the entity enters into a reinsurance contract that covers 30% of each claim arising from the underlying contracts. The single reinsurance premium paid on initial recognition is 300 and 260 in Scenarios 1 and 2, respectively. 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 underlying group of contracts is initially recognised.

IFRS 17:IE124–IE129

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.

	Group of insurance contracts issued	Reinsurance contract held – Scenario 1	Reinsurance contract held – Scenario 2
Estimates of the present value of cash inflows	(1,000) <i>Premiums</i>	(270) <i>Claims recovery</i>	(270) <i>Claims recovery</i>
Estimates of the present value of cash outflows	900 <i>Claims</i>	300 <i>Premiums</i>	260 <i>Premiums</i>
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

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)
CSM	0	(12)	28
Loss recognised on initial recognition	110	0	0

This results in a group of onerous contracts for the underlying contracts on initial recognition. Therefore, X recognises a loss for its onerous group of underlying contracts. However, this does not affect the amounts of the CSM recognised for the reinsurance contract held under both scenarios.



KPMG insight – 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 additional potential practice 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.

Reinsurance gain or loss is recognised over the reinsurance coverage period

Current practice in some jurisdictions maintains a stronger link between recognising the reinsurance contract cost/gain and the underlying contract's profit/loss recognition.

For example, some practices include recognising an immediate reinsurance gain on initial recognition when the underlying insurance contracts are onerous (see [Example 15.2](#)). This will no longer apply under IFRS 17.

Reinsurance asset impairment included in the measurement model

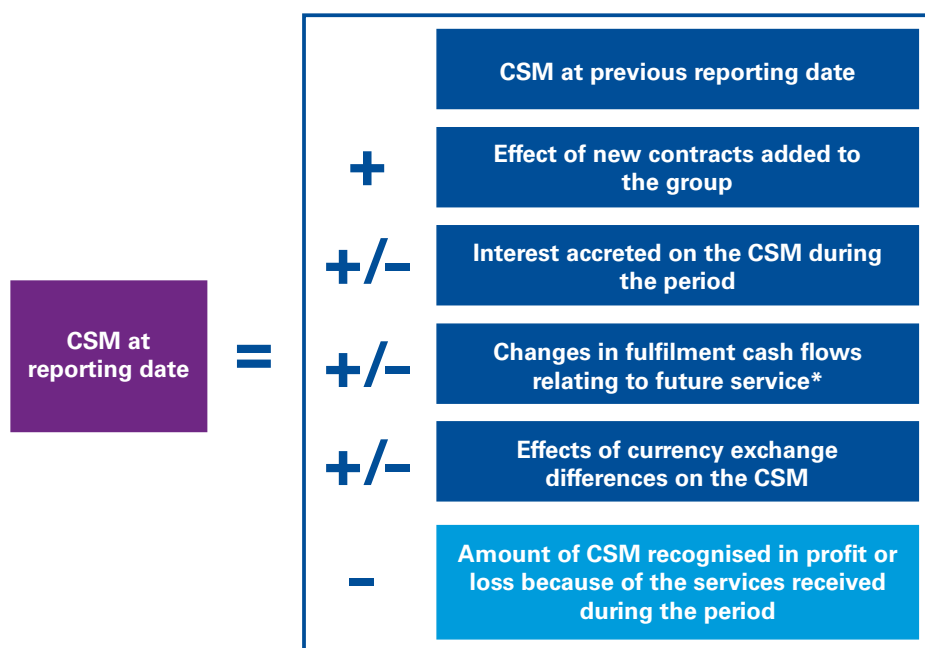
Current practice applies an impairment assessment to reinsurance contracts assets (reinsurance receivables). This is no longer needed as a separate exercise under IFRS 17, because any non-performance risk is included in the measurement of the reinsurance contract held from its inception and throughout subsequent periods. 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: 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.

IFRS 17.66(c)(iii), BC315, IE138

When a change in the fulfilment cash flows allocated to a group of underlying contracts that relate to future service does not adjust the CSM for the group of underlying contracts, the corresponding changes in the fulfilment cash flows relating to future service of the reinsurance contracts held are also recognised in profit or loss. This arises when losses on onerous groups of underlying contracts 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 with a change in the fulfilment cash flows of the group of reinsurance contracts held, the net effect on profit or loss will be reduced.

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.



KPMG insight – Matching on subsequent measurement

Although on initial recognition of an onerous group of underlying contracts the loss is recognised immediately and any related reinsurance gain on initial recognition of a reinsurance contract is deferred, some level of matching between the two groups of contracts is provided on subsequent measurement.

IFRS 17.1E130–IE138

The adjustment to the CSM of a group of reinsurance contracts is limited to when the changes in fulfilment cash flows of the group of underlying contracts adjust the underlying contracts' CSM. 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

Presentation of reinsurance contracts held

IFRS 17.78

In the statement of financial position, groups of reinsurance contracts held are presented separately from groups of insurance contracts issued. Those held that are assets are presented separately from those that are liabilities.

IFRS 17.82

Similarly, in the statement(s) of financial performance, income or expense from groups of reinsurance contracts held is presented separately from income or expense from insurance contracts issued.

IFRS 17.82, 86, BC346

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); and
 - 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.

IFRS 17.88

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](#).



KPMG insight – 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 their decisions on upgrading or developing new systems, processes and controls for insurance contracts that they issue, to be used for reinsurance contracts held.

18

Insurance contracts acquired

Acquired insurance contracts 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 or transfer of insurance contracts 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 17.B94, BC166, IFRS 13.47

For contracts acquired in a business combination, this consideration is deemed to be the contracts' fair value at the transaction 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.B95

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 or a transfer of insurance contracts.

IFRS 17.B95

Type of transaction	Onerous contracts
Business combination	Recognise the difference as a part of the goodwill or gain on a bargain purchase.
Transfer of insurance contracts	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.BC326–BC327, IE139–IE151

**Example 16 – Measuring insurance contracts acquired in a business combination**

On 31 December 2021, Entity C completes a business combination transaction and acquires, among other assets and liabilities, insurance contracts that have been in force for 10 years. The fair value of the liability for these contracts at the transaction date is 30. On the date of acquisition:

- under Scenario A, the entity estimates that the fulfilment cash flows are 20; and
- under Scenario B, the entity 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 2021.

On initial recognition, C measures the insurance contract liability as follows.

	Scenario A	Scenario B
Fulfilment cash flows	20	45
CSM	10	-
Insurance contract liability on initial recognition	30	45

Scenario A

The fair value exceeds the fulfilment cash flows. Therefore, the difference of 10 represents the CSM on initial recognition. The entity initially measures the contracts acquired at their fair value of 30.

Scenario B

Because the fulfilment cash flows exceed the fair value, there is no CSM. Therefore, the portfolio is initially measured at the fulfilment cash flows of 45.

The excess of the fulfilment cash flows over the contract's fair value – i.e. $45 - 30 = 15$ – effectively increases the goodwill to be recognised. This might be the case if the acquirer 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 and a loss component for the liability for remaining coverage would be established for the same amount.

IFRS 17.C4, BC324, IFRS 3.18, IFRS 4.31–33



KPMG insight – 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. 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, on transition, all such intangible assets are eliminated. However, any intangible assets reflecting a separate customer relationship will continue to be recognised because they usually represent the expectation of future contracts.

For more discussion on transition requirements, see [Chapter 20](#).



KPMG insight – 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 17B3–B5



KPMG insight – Contracts acquired in their settlement period

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 transfer of insurance contracts or a business combination 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 such. To determine this, entities will need to assess whether significant insurance risk still exists at the date of acquisition.

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

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 a loss event incurs. However, for similar contracts acquired after that period has passed, the discovery of 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 motor insurance contracts issued five years ago with long-tail claims, and it also acquires a group of similar 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 an extended period. 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 eligible to apply the PAA for the contracts that it issued, because their coverage period is one year. However, considering the long coverage period of the acquired contracts, it is possible that the PAA might not apply.

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 in order 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 groups of contracts that are assets and a total for those 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	
<p>Based on the components comprising the total asset or liability, which are:</p> <ul style="list-style-type: none"> – the net liability (or asset) for remaining coverage, excluding any loss component; – any loss component; and – the liability for incurred claims¹ 	<p>These amounts include:</p> <ul style="list-style-type: none"> – insurance revenue; – insurance service expenses; – incurred claims and other expenses; – amortisation of insurance acquisition cash flows; – changes that relate to past service – i.e. changes in fulfilment cash flows relating to the liability for incurred claims; – changes that relate to future service – i.e. losses on onerous groups of contracts and reversals of such losses; and – investment components excluded from insurance revenue and insurance service expenses.
<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 future 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 future cash flows and the risk adjustment for non-financial risk that comprise the liability for incurred claims.</p>	

The following table, extracted from the IASB's *Effects Analysis* for IFRS 17, 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 reversal 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, extracted from the IASB's *Effects Analysis* for IFRS 17, 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 future cash flows, the risk adjustment for non-financial risk and the CSM.

	Estimates of the present value of future 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)
Expiration 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 reversal 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 17.98, 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.
- An explanation of when the entity expects to recognise the remaining CSM at the reporting date in profit or loss – this disclosure may be made quantitatively or qualitatively.



IFRS 17 vs IFRS 4 – New business issued and business in force comparison

IFRS 17.107–108

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 IFRS financial statements, 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 future cash flows arising from the exercise of discretion from other changes in estimates of future cash flows for contracts without direct participation features;
- determine the risk adjustment for a non-financial risk, including whether it disaggregates changes in that risk into an insurance finance component and a service component;
- determine discount rates; and
- determine investment components.

IFRS 17.118

If the entity applies the disaggregation policy choice (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 is required to disclose 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 future 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 exposures 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 groups of insurance contracts issued and groups 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 2021. The transition method applied depends 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 2021. Earlier application is permitted for entities that apply IFRS 9 and IFRS 15 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 – i.e. the beginning of the period in which an entity first applies 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](#)).



KPMG insight – Differing effective dates of IFRS 9 and IFRS 17

The differing effective dates of IFRS 9 (1 January 2018) and IFRS 17 (1 January 2021) 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 IASB 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).

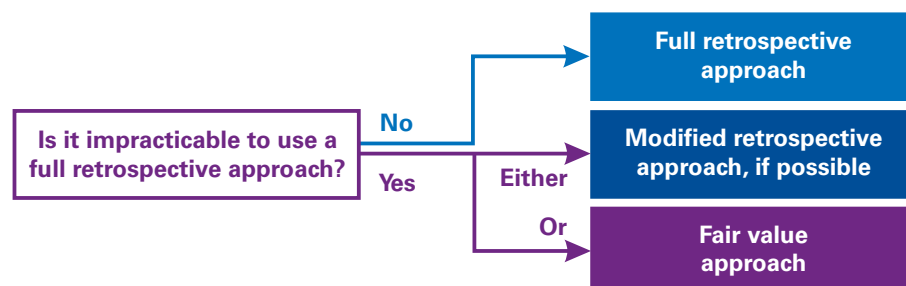
Our publication [First Impressions: Insurance amendments](#) provides an overview of the amendments and a discussion of their key elements.

20.2

IFRS 17.C3–C4, BC375–BC378

Retrospective application

IFRS 17 is applied retrospectively unless this is impracticable.



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. The following two areas may be complex.

- **Determining the CSM or loss component:** The fulfilment cash flows components 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 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 as if IFRS 17 had always been applied; and
- derecognises any existing balances that would not exist if IFRS 17 had always been applied.

IFRS 17.C3(b)

However, if an entity uses a derivative to mitigate financial risk arising from a group of direct participating insurance contracts, then the option to exclude all or some of the effect of the changes in the financial risk arising from the group of insurance contracts from the CSM is applied prospectively from the date of initial application (see 15.3.3).

IAS 8.5



KPMG insight – Full retrospective application

Full retrospective application will typically be a difficult exercise requiring significant time, effort, 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 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 if a full retrospective approach were applied.

For groups of shorter-duration contracts, these difficulties will be less significant, because their initial 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 relatively short coverage periods, and the challenges around determining the CSM do not arise.

IFRS 17.C5–C6

Only when it is impracticable for an entity to complete a full retrospective application for a group of contracts can an entity choose between applying a modified retrospective approach and the fair value approach. This choice is relevant for a group of contracts only if reasonable and supportable information can be obtained to apply the modified retrospective approach; otherwise, the fair value approach is applied.

IAS 8.5

The use of hindsight might result in retrospective application being 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:
 - provide 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. However, 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

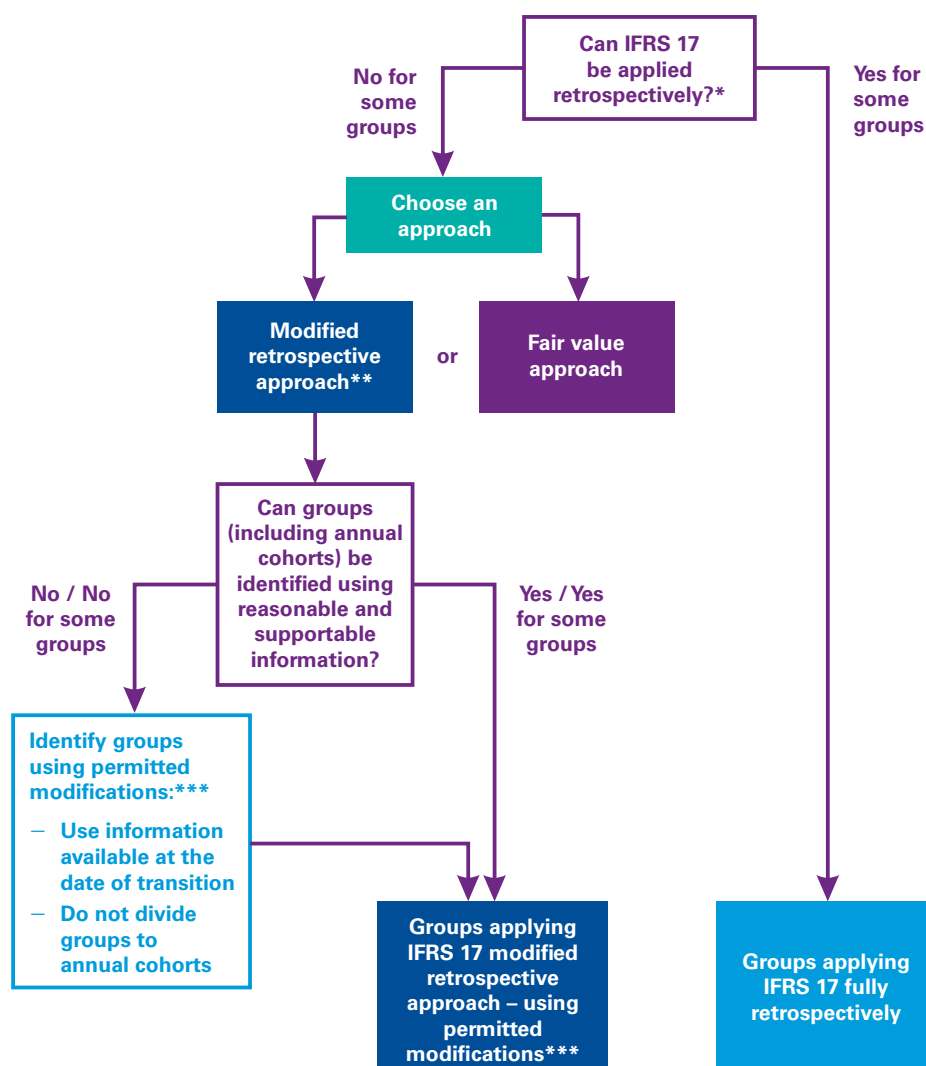
When applying the modified retrospective approach, an entity maximises the use of information that is available without undue cost or effort that would have been used to apply a full retrospective approach. Therefore, an entity uses each of the

IFRS 17.C9–C10

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.

To the extent that an entity is not able to identify groups of contracts, and the contracts' 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); and
- how to identify discretionary cash flows for contracts without direct participation features (see 10.2.2.1).



Notes:

* Retrospective application of IFRS 17 is required, unless impracticable.

** If an entity cannot obtain reasonable and supportable information to apply the modified retrospective approach, then it applies the fair value approach.

*** Using permitted modifications only to the extent reasonable and supportable information is not available to apply a retrospective approach.

20.2.2.1

IFRS 17C9–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.

Amount to be determined for a group of contracts	As of date	Permitted modification
Future cash flows	Initial recognition	<p>Estimated as the amount of the future 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 future cash flows can be determined retrospectively for an earlier date than the date of transition, then that amount is used instead.</p>
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>

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 as 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.



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 2021 – i.e. the date of initial application. The beginning of the earliest period presented is 1 January 2020 – 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

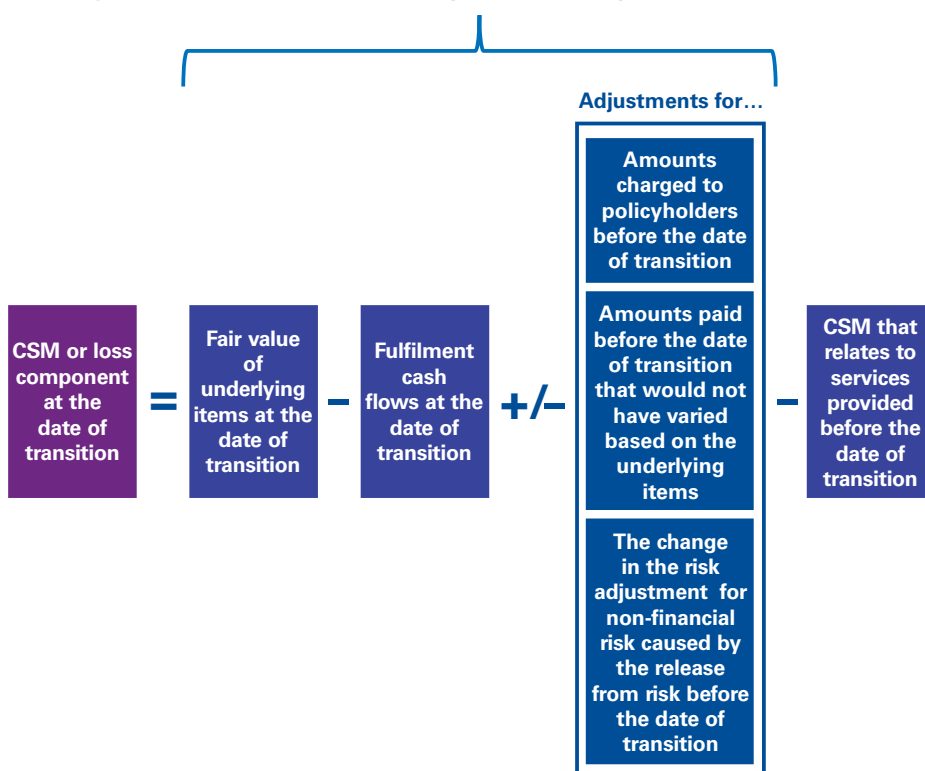
20.2.2.2

IFRS 17C17

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.

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 2021 – i.e. the date of initial application. The beginning of the earliest period presented is 1 January 2020 – 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

20.2.2.3

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 disaggregation policy choice 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 disaggregation policy choice 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>

20.2.3

IFRS 17.C20

IFRS 17.C21–C23

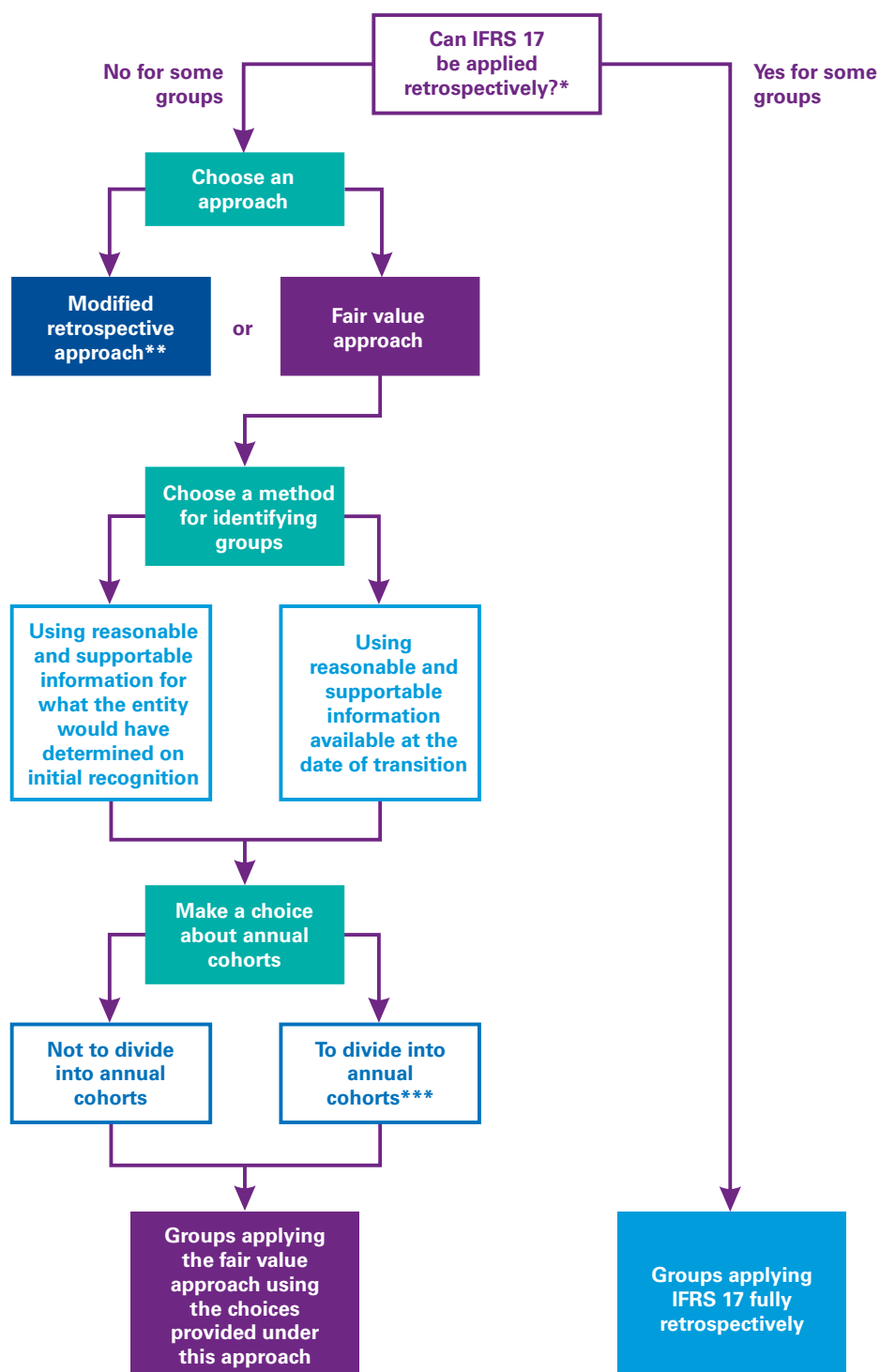
Fair value approach

Using 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.

When this 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](#)); and
- how to identify discretionary cash flows for insurance contracts without direct participation features (see [10.2.2.1](#)).

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:

* Retrospective application of IFRS 17 is required, unless impracticable.

** If an entity cannot obtain reasonable and supportable information to apply the modified retrospective approach, then it applies the fair value approach.

*** Only if reasonable and supportable information is available to do so.

IFRS 17.C23

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 disaggregation policy choice for insurance finance income or expense.

IFRS 17.C24

If an entity applies the disaggregation policy choice for insurance finance income or expense, then the amount accumulated in OCI on the date of transition is:

- determined retrospectively – if reasonable and supportable information is available – or;
- determined 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, zero.



KPMG insight – 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 they will have been applied to, 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.



KPMG insight – Practical implementation of the transition requirements

Applying the transition requirements is expected to be a challenging exercise. Entities will first need to determine whether 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 only available 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 IFRS 17's requirements. Determining an explicit risk adjustment for non-financial risk might be an example of this, because in some jurisdictions entities 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 on-going 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 will 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 its 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 disaggregation policy choice 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

**KPMG insight – Disclosures before IFRS 17 is adopted**

During the period before IFRS 17 is initially applied, an entity discloses known or reasonably estimable information relevant to assessing the possible impact that applying IFRS 17 will have on an entity's financial statements in the period of initial application.

During the transition period – i.e. before adoption of IFRS 17 – an entity discloses known or reasonably estimable information relevant to assessing the possible impact that applying IFRS 17 will have on an entity's financial statements in the period of initial application.

20.4

Redesignation of financial assets

The interaction between the classification of financial assets and the presentation of changes in the 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 explain 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 applied IFRS 9 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.



KPMG insight – Comparative information for financial assets

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 17. 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**KPMG insight – 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 2021, it would present restated statements of financial position at 31 December 2021, 2020, and 1 January 2020.

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.

About this publication

This publication has been produced by the KPMG International Standards Group (part of KPMG IFRG Limited).

This edition considers the requirements of IFRS 17 *Insurance Contracts* published by the IASB in May 2017.

The text of this publication refers to IFRS 17 and to selected other current standards in issue at 1 July 2017.

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.

Acknowledgements

We would like to acknowledge the efforts of the following members of the KPMG International Standards Group, who were the principal authors of this publication: Bryce Ehrhardt, Hagit Keren and Lindsey Stewart.

We would also like to thank the members of KPMG's global IFRS insurance topic team for their contribution:

Jennifer Austin	US
Erik Bleekrode	The Netherlands
Dana Chaput	Canada
Danny Clark	UK
Paolo Colciago	Italy
Gerdus Dixon	South Africa
Frank Dubois	Singapore
Bhaves Gandhi	Kuwait
Alan Goad (co-deputy leader)	US
Scott Guse	Australia
Joachim Kölschbach (leader)	Germany
Viviane Leflaive	France
Csilla Leposa	Hungary
Luciene Magalhaes	Brazil
Chris Spall	UK
Mary Trussell (co-deputy leader)	Germany

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kpmg.com/ifrs

Publication name: First Impressions: IFRS 17 *Insurance Contracts*

Publication number: 134753

Publication date: July 2017

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