IFRS 17: A Big change for Insurance

On May 18, IASB published IFRS 17 on Insurance Contracts after nearly 20 years of discussion. IFRS 17 will fundamentally change the accounting for all entities that issue contracts within the scope of the standard for insurance contracts. The issuers of insurance contracts will need to use consistent measurement models based on current assumptions at a more granular level. Both the income statement and balance sheet will change. There are a number of decisions and choices to be made when implementing the new standard.

Designed to achieve the goal of a consistent, principle-based accounting for insurance contracts, the new Standard requires insurance liabilities to be measured at a current fulfilment value and provides a more uniform measurement and presentation approach for all insurance contracts.

IFRS 17 supersedes IFRS 4 Insurance Contracts and related interpretations and is effective for periods beginning on or after 1 January 2021, with earlier adoption permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial instruments have also been applied.

Background

IFRS 17 began as an IASB project to undertake a comprehensive review of accounting for insurance contracts when the IASB added the project to its agenda in September 2001, taking over the equivalent project started in April 1997 by the IASB's predecessor body. During the past 16 years of development, the project was better known as "IFRS 4 Phase II".

The IASB's objective was to develop a common, high-quality standard that will address recognition, measurement, presentation and disclosure requirements for insurance contracts. In February 2014, the FASB tentatively decided to abandon its convergence work with the IASB on insurance contracts that they had started in October 2008. Instead, FASB decided to focus its future efforts on making targeted improvements to the existing U.S. GAAP insurance accounting model.

The IASB issued a discussion paper in 2007 and the first exposure draft "ED/2010/8 Insurance Contracts" in July 2010. A second targeted revised exposure draft "ED/2013/7 Insurance Contracts" was published on 20 June 2013. The IASB finalised its deliberations in February 2016 and made the last set of amendments in February 2017 as a result of the field test activities conducted during the summer of 2016.

Scope

An entity shall apply IFRS 17 Insurance Contracts to:

- Insurance and reinsurance contracts that it issues;
- Reinsurance contracts it holds; and
- Investment contracts with discretionary participation features (DPF) it issues, provided it also issues insurance contracts.

Scope changes from IFRS 4

- The requirement, that in order to apply the insurance standard to investment contracts with DPF, an entity has to also issue insurance contracts.
- An option to apply IFRS 15 Revenue from Contracts with Customers to fixed-fee contracts, provided certain criteria are met.

Level of aggregation

IFRS 17 requires entities to identify portfolios of insurance contracts, which comprise contracts that are subject to similar risks and are managed together. Each portfolio of insurance contracts issued shall be divided into a minimum of three groups:

- A group of contracts that are onerous at initial recognition, if any;
- A group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and
- A group of the remaining contracts in the portfolio, if any.
- An entity is not permitted to include contracts issued more than one year apart in the same group. Furthermore, if a portfolio would fall into different groups only because law or regulation constrains the entity's practical ability to set a different price or level of benefits for policyholders with different characteristics, the entity may include those contracts in the same group.

Overview of the new accounting model

The Standard measures insurance contracts either under the general model or a simplified version of this called the Premium Allocation Approach. The general model is defined such that at initial recognition an entity shall measure a group of contracts at the total of (a) the amount of fulfilment cash flows (FCF), which comprise probability-weighted estimates of future cash flows, an adjustment to reflect the time value of money (TVM) and the financial risks associated with those future cash flows and a risk adjustment for non-financial risk; and (b) the contractual service margin (CSM).

On subsequent measurement, the carrying amount of a group of insurance contracts at the end of each reporting period shall be the sum of the liability for remaining coverage and the liability for incurred claims. The liability for remaining coverage comprises the FCF related to future services and the CSM of the group at that date. The liability for incurred claims is measured as the FCF related to past services allocated to the group at that date.

An entity may simplify the measurement of the liability for remaining coverage of a group of insurance contracts using the premium allocation approach on the condition that, at initial recognition, the entity reasonably expects that doing so would produce a reasonable approximation of the general model, or the coverage period of each contract in the group is one year or less.

Presentation in the statement of financial performance

An entity shall disaggregate the amounts recognised in the statement(s) of financial performance into an insurance service result, comprising insurance revenue and insurance service expenses, and insurance finance income or expenses. Income or expenses from reinsurance contracts held shall be presented separately from the expenses or income from insurance contracts issued.

An entity shall present in profit or loss revenue arising from the groups of insurance contracts issued, and insurance service expenses arising from a group of insurance contracts it issues, comprising incurred claims and other incurred insurance service expenses. Revenue and insurance service expenses shall exclude any investment components.

Effective date

IFRS 17 is effective for annual reporting periods beginning on or after 1 January 2021. Earlier application is permitted if both IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial instruments have also been applied.

Transition

An entity shall apply the Standard retrospectively unless impracticable, in which case entities have the option of using either the modified retrospective approach or the fair value approach.

At the date of initial application of the Standard, those entities already applying IFRS 9 may retrospectively re-designate and reclassify financial assets held in respect of activities connected with contracts within the scope of the Standard.

- Various sources

Please feel free to contact us at contact@xactitude.in for any further queries.