



Singapore Actuarial Society

**TECHNICAL NOTE FOR IFRS 17 IMPLEMENTATION BY
GENERAL INSURERS IN SINGAPORE**

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1. General

1.1. Introduction

This Technical Note was produced by the International Financial Reporting Standard (“IFRS”) 17 General Insurance Working Party of the Singapore Actuarial Society. The Working Party consists of members of the Singapore Actuarial Society who are based in Singapore and actively working in actuarial reporting roles with direct general insurers or reinsurers, as well as actuarial representatives from the BIG 4 audit firms and actuarial consultancies.

This IFRS 17 Technical Note (this Technical Note) is intended for experienced actuaries practicing in Singapore and involved with financial reporting activities.

1.2. Purpose

The purpose for this Technical Note is to provide members of the Singapore Actuarial Society with considerations specifically applicable to general insurance business.

This Technical Note aims to facilitate discussion among actuaries and other stakeholders to capture the range of opinions on the application of IFRS17 in the Singapore context and is not meant to serve as mandatory practice notes. Any interpretation of IFRS17 set out in this Paper represents a plausible treatment given the text of IFRS17. However, it shall neither be construed as the only possible treatment nor the agreed interpretation for Singapore insurers. Users of this Technical Note shall be mindful that differences in the exact fact pattern and operating context facing each insurer may drive different interpretations. Users shall also be mindful that for the same fact pattern and operating context, there is scope for the substance of same transaction to be articulated differently depending on how the transaction is analysed. Differences in articulation can give rise to a range of plausible treatments. An insurer remains responsible for justifying its choice of treatment after discussion with its auditor. Opinions expressed in the Technical Notes are not representative of that of the Singapore Actuarial Society.

1.3. Scope

The scope of this paper includes insurance contracts written and reinsurance contracts held by an insurer or a reinsurer licensed in Singapore to carry out general (or non-life) insurance business. To the extent possible the examples presented here have been tailored to be relevant for general insurance actuaries.

This paper is not intended to provide guidance to accountants, although accountants may find it useful in carrying out their duties in relation to IFRS 17.

1.4. Reliance on contents

We highlight that a number of implementation issues remain to be resolved and there is ongoing discussion and debate on various aspects of IFRS 17 interpretation. In particular, it is important to note that no insurer in Singapore would have fully transitioned to IFRS 17 at the time of writing of this Technical Note. We would like to therefore reiterate that this is a working draft and that it will be revised as understanding of IFRS 17 develops.

This Technical Note is not a Standard of Actuarial Practice or Guidance Note of the Singapore Actuarial Society.

2. A Brief Summary of IFRS 17

In May 2017, the International Accounting Standards Board (“IASB”) released a standard to govern the accounting of insurance contracts. IFRS 17 Insurance Contracts establishes the principles for the recognition, measurement, presentation and disclosure of insurance contracts within the scope of the standard.

The scope of IFRS 17 covers:

- Insurance contracts, including reinsurance contracts, issued;
- Reinsurance contracts held; and
- Investment contracts with discretionary participation features issued, provided the entity also issues insurance contracts.

We recommend that the reader carry out relevant background reading on the core requirements of IFRS 17, beyond which is presented in this Technical Note.

2.1. Timeline:

IFRS 17 is effective for annual reporting periods beginning on or after 1 January 2021. There has been recent debate and discussion at the IASB on the potential delay in the effective date of the standard. On the 14th of November 2018 the IASB voted to propose a one-year delay to the effective date of the standard. This change will be subject to public consultation.

3. Key IFRS 17 Issues Faced by General Insurers

3.1. Recognition of insurance contract

3.1.1. IFRS 17 reference:

3.1.1.1. Paragraph 25: An entity shall recognise a group of insurance contracts it issues from the earliest of the following:

- The beginning of the coverage period of the group of contracts;
- The date on which the first payment from a policyholder in the group becomes due; and
- For a group of onerous contracts, when the group becomes onerous.

3.1.1.2. Paragraph 26: If there is no contractual due date, the first payment from the policyholder is deemed to be due when it is received.

3.1.2. Key implementation issues faced by general insurers:

3.1.2.1. It is not unusual for general insurers to receive premiums before the start of the insurance coverage provided by a written contract. Examples are contracts with large sum assureds and renewal of some insurance contracts.

3.1.2.2. Currently, the main recognition method for insurance revenue under local reporting practice is in terms of gross premiums, which includes all written contracts regardless of whether coverage has commenced. IFRS 17 is a departure from current practice where only premiums from commenced contracts are accounted as revenue.

3.1.2.3. This shift represents a key implementation consideration as revenue recognition will have to be changed and premiums received for pre-commenced contracts will be excluded. Some insurance contracts, such as open marine contracts, can lead to recognition difficulties as the date of coverage commencement may not be immediately apparent.

3.1.2.4. While, in theory, the IFRS 17 method of insurance revenue recognition will not differ should insurers currently recognize earned premiums as insurance revenue, the presence of multi-year contracts and timings of premiums received could mean modifications, albeit possibly less changes are needed for current mechanisms.

- 3.1.2.5. Contracts should not be recognized for advanced premiums and post-dated premiums in the profit and loss statement until the beginning of the coverage period. These premiums, however, will affect the asset and liabilities (specifically LRC) by the same magnitude, resulting in zero net effect unless the business underlying these premiums are expected to be onerous at initial recognition.

3.2. Contract Modification and De-recognition

3.2.1. IFRS 17 reference:

- 3.2.1.1. Paragraph 72: If the terms of an insurance contract are modified, an entity shall derecognise the original contract and recognise the modified contract as a new contract if there is a substantive modification, if any of the specified criteria is met.
- 3.2.1.2. Paragraph 74: An entity shall de-recognise an insurance contract when it is extinguished or substantially modified.

3.2.2. Key implementation issues faced by general insurers:

- 3.2.2.1. A modification of an insurance contract in the context of IFRS 17 are changes to the legally enforceable terms of the contract. Examples include any of the following:

- Change to the sum insured under the contract.
- Extension or reduction in the duration of the contract.
- Change to the benefits under the contract (e.g. decreasing the in-patient hospitalization benefit).
- Change to the coverage (e.g. adding an additional driver to a motor policy).
- Change in the contract due to changes in regulation.
- Change in the premium.

It is important to note that any of the above events and/or any combination of events only constitutes a modification when:

- a) These changes are not a consequence of options stated in the contracts being exercised;
and
- b) Expected future cash flows will be altered.

Consideration of modifications should be made alongside the contract boundary consideration. Modification only arises from changes to terms and cashflows of the contract that are within the contract boundary.

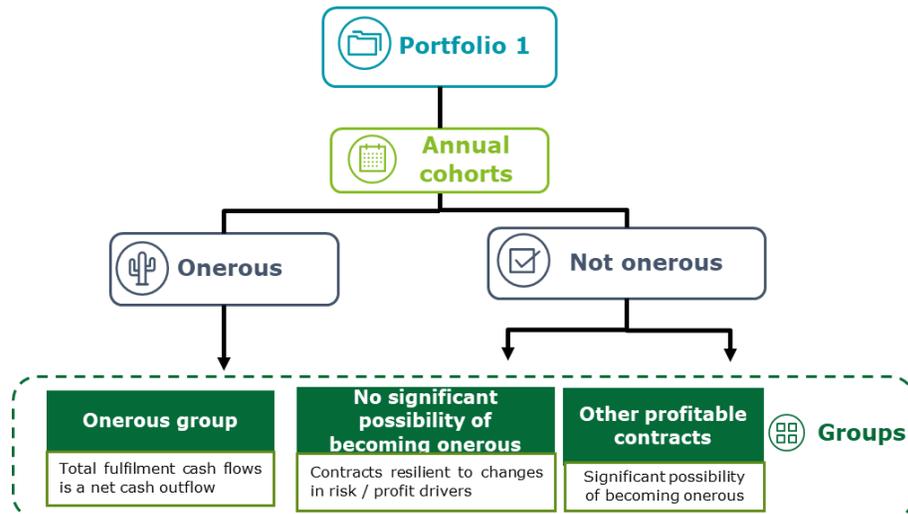
- 3.2.2.2. Insurers will have to decide what constitutes as a significant modification e.g. changes to main/specific coverage features. A process flow can be set up with inputs from relevant stakeholders, such as underwriting teams, to automatically decide when to de-recognise and re-recognise such contracts.

3.3. Level of Aggregation

3.3.1. IFRS 17 reference:

- 3.3.1.1. Paragraph 14: An entity shall identify portfolios of insurance contracts. A portfolio is a group of contracts subject to similar risks and managed together as a single pool.

- 3.3.1.2. Paragraph 16: An entity shall divide a portfolio of insurance contracts issued into a minimum grouping of:
- Contracts that are onerous at initial recognition, if any;
 - Contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and
 - The remaining contracts in the portfolio, if any.
- 3.3.1.3. Further disaggregation of the specified groups is permitted.
- 3.3.1.4. Only contracts issued within the same twelve-month period are permitted to be grouped together. Groups for shorter periods are permitted. This period does not need to coincide with the annual reporting period of an entity.
- 3.3.1.5. An entity shall establish the groups at initial recognition, and shall not reassess the composition of the groups subsequently.
- 3.3.1.6. Paragraph 9: Riders sold with main contract as a single package could be merged into the main contract.



3.3.2. Key implementation issues faced by general insurers:

3.3.2.1. Basis of aggregation

- An entity will need to have a guideline to determine when risks are regarded as similar and to decide whether they are to be managed together. Contracts within each product line, such as motor comprehensive and third party cover, would be expected to have similar risks, and hence contracts in different reserving lines would be expected to be in different portfolios.
- Reserving classes with similar risk characteristics and/or portfolios which are managed using the same underwriting process, sales or marketing process, administrative system, regulatory treatment and distribution channel may be treated as portfolios that are managed together. This could mean that reserving classes are split further. For example, contracts through an online sales channel may be managed separately and have different profitability to the agency channel.

3.3.2.2. Unbundling packaged policies

- Most general insurers with commercial customers sell packaged policies – policies offering multiple types of insurance coverage e.g. workers’ compensation, property. Typically, the different types of risks are priced separately and then combined together where adjustments are made to make premiums more competitive. This results in some risk components to be (potentially) onerous.
- Should these policies be sold as single contracts, or component risks (while sold under multiple contracts) be deemed to be dependent on each other, the insurer can elect to not unbundle these policies. Careful and consistent judgement will need to be applied to such policies e.g. considering balance between granularity and time, and as to whether multiple contracts are issued as a single policy.
- The purpose and intention of the packaged policy needs to be considered, for example, whether the risks are combined for administrative purposes, or issued as a genuine single policy that gives the policyholder a discount to the premiums for individual policies covering each risk.

3.3.2.3. Regulatory requirements

- It is worth noting that MAS groupings may not be appropriate for IFRS17 level of aggregation due to differing purposes between MAS reporting and monitoring and IFRS 17 reporting. The former would be concerned with the strength and solvency of the insurance market whereas IFRS17 is concerned with the appropriate reporting of profit and loss.
- Grouping that is used for local reporting and/or management reporting (e.g. for portfolio monitoring purpose) may also be used as a factor in determining portfolios.

3.3.2.4. Determination of onerous contracts

- Onerous contracts are determined based on both the qualitative criteria to be defined by the local quantitative criteria (liability adequacy test or “LAT”)¹ or by the group company (if any). An entity should assess as to whether the risk of the contracts in a group are onerous in a manner consistent with how the entity’s internal reporting provides information about changes in estimates such as sensitivity analyses or risk-adjusted profitability analyses.
- An entity should assess whether there is no significant risk of the contracts in the group becoming onerous, based on the sensitivity of the fulfilment cash flows to changes in estimates which, if they occurred, would result in the contracts becoming onerous.
- An entity may choose to divide the portfolios into more groups if the entity’s internal reporting provides information that distinguishes at a more granular level profitability and different risks of contracts becoming onerous.
- When assessing the combined ratio, consisting of expected fulfilment cash flows, risk adjustment and time value of money per IFRS 17 requirements, insurers need to be

¹ [Insurance \(Valuation and Capital\) Regulations 2004, Paragraph 19](#): Liability Adequacy Test is prescribed by Monetary Authority of Singapore (“MAS”), which determines whether a reporting entity requires a premium deficiency reserve (“PDR”). This is done through setting higher of a) unearned premiums and b) expected losses and expenses from unearned premiums as premium liability – a PDR will be required if b) is higher than a).

careful of confusing it with the conventional combined operating ratio, which does not consist of the latter two components. A distinct term e.g. “IFRS 17 Combined Operating Ratio”, could be used to differentiate from the conventional combined operating ratio.

- A threshold can be determined in terms of combined operating ratio under IFRS 17, which when exceeded, will require additional investigation to validate the choice of profitability categorisation.

3.3.2.5. Unit of accounts – granularity level

- While in extremis an entity can separately examine each individual contract to fulfil IFRS 17 reporting requirements, the entity can calculate certain IFRS 17 requirements at a lower granularity level in terms of “unit of accounts”. Possible granularity levels can be as follows. Exact granularity selected would be dependent on entity’s operational model:

IFRS 17 Requirement	Possible Level of Unit of Account
Scope	Contract
Contract Measurement and De-recognition	Contract
Acquisition Costs	Portfolio
Contractual Service Margin	Group
Contractual Service Margin Release	Group
Risk Adjustment	Up to reporting entity-wide
Onerous Contract Test	Group

- The entity can decide on acceptable granularity levels for each IFRS 17 requirement by examining the common characteristics across different contracts e.g. uncertainty levels are likely to be similar across different lines of business operating in the same geographic region – hence Risk Adjustment can be estimated on an entity-wide level by combining all contracts together.

3.3.2.6. Reinsurance

For reinsurance contracts, the contract may be used as the level of aggregation.

3.3.3. Other considerations:

- 3.3.3.1. An entity may decide the grouping such that the portfolios can be linked to the groupings aggregated by its Group company in preparing consolidated financial statements.
- 3.3.3.2. If an entity has disclosed operating segments under IFRS 8 (e.g. geographical segments, composite / regional / entity), these segments should be taken into account in determining the portfolios.
- 3.3.3.3. An entity may change its business model over time and therefore level of aggregation may need to be re-assessed regularly.

3.4. IFRS 17 Measurement Models

3.4.1. Definitions provided by IFRS 17:

3.4.1.1. The general measurement model (“GMM”) is the base model for measuring insurance contracts under IFRS 17. The insurance contract is valued considering the following building blocks:

- Paragraph 38: Contractual service margin – The unearned profit that the insurer recognizes as it provides services
- Paragraph 37: Risk adjustment – The compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract
- Paragraph 36: Discount rate – The discount rate that reflects the characteristics of the liabilities (in particular the time value of money)
- Paragraph 33: Expected future cash flows – An explicit, unbiased and probability-weighted estimate of future net cash flows that will arise as the entity fulfils the insurance obligations.

3.4.1.2. The premium allocation approach (“PAA”) is an optional simplified approach for contracts with a coverage period of one year or less, or where it is a reasonable approximation to the GMM. It is similar to existing non-life insurance contract approaches or pre-claims coverage liability (unearned premium).

3.4.2. Key implementation issues faced by general insurers:

3.4.2.1. PAA or GMM

- Many non-life insurance contracts are expected to meet the PAA criteria.
- Paragraph 53: the simplified approach can be used if and only if at inception -
 - (a) The entity reasonably expects that such simplification would produce a measurement of the liability for remaining coverage for the group that would not differ materially from the one that would be produced applying the GMM; or
 - (b) The coverage period of each contract in the group of insurance contracts is one year or less.
- Hence, all contracts that are 12 months or less will subsequently be able to be approximated under the PAA approach unless they are determined to be onerous and then an approach to determine the additional liability above the pre-claims coverage liability would need to be considered.
- For a long-term contract, the insurer would need to consider materiality on the base inception assumptions and the plausibility of future outcomes to assess whether such a simplification could be adopted:
 - a. Increase/decrease in expected loss ratio for the remaining coverage
 - b. Upwards/downwards interest rate shock
 - c. Difference in earnings patterns from the passage of time
 - d. Claims payment pattern
 - e. Significant financing elements

The assessment could be considered for each individual contract and then aggregated for the number of contracts within the product type to consider the overall impact.

3.4.2.2. Onerous contracts

- An insurance contract is onerous at the date of initial recognition if the fulfilment cash flows allocated to the contract, any previously recognized acquisition cash flows and any cash flows arising from the contract at the date of initial recognition in total is a net outflow.
- Under IFRS 17, contracts that are measured under PAA, the assumption is that there are no onerous contracts at initial recognition, unless facts and circumstances indicate otherwise. If at any time during the coverage period, facts and circumstances indicate that a group of insurance contracts is onerous, the liability for remaining coverage (“LRC”) must be calculated using GMM.
- Incurred claims experience resulting in a cohort being loss-making does not translate to LRC being onerous. The entity will have to form a view as to whether the cohort’s LRC will be similar to the incurred experience and hence consider to be onerous. For example, if actions are taken to improve the profitability of the cohort, a cohort which has historically been onerous may be justified to be non-onerous going forward.

3.4.3. Other considerations:

- 3.4.3.1. The level of materiality in the GMM and PAA assessment will need to be considered and this would need to be discussed closely with the management alongside the external auditors. The assessment in terms of whether the PAA is an appropriate simplification would need to be conducted at least on an annual basis. However, this approach could leverage prior exercises to test PAA eligibility.

3.5. Risk Adjustment (“RA”)

3.5.1. Definitions provided by IFRS 17:

- 3.5.1.1. Paragraph 37: An entity shall adjust the estimate of the present value of the future cash flows to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.
- 3.5.1.2. Application Guidance, paragraph B87: The risk adjustment for non-financial risk for insurance contracts measures the compensation that the entity would require to make the entity 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 contracts.”
- 3.5.1.3. Application Guidance, paragraph B88: The risk adjustment for non-financial risk also reflects both favourable and unfavourable outcomes, in a way that reflects the entity’s degree of risk aversion.

3.5.2. Comparable definitions

- 3.5.2.1. A provision for adverse deviation (“PAD”) is required for reporting under Insurance (Valuation and Capital) Regulations (“V&C Regulations”). The required provision is based on a 75% level of sufficiency.

3.5.2.2. Commonly used methods to determine the PAD include:

Claims Liability	Premium Liability
<ul style="list-style-type: none"> • Industry benchmarks • Bootstrapping • Mack Method 	<ul style="list-style-type: none"> • Industry benchmarks • Factor multiple of Claims Liability PAD

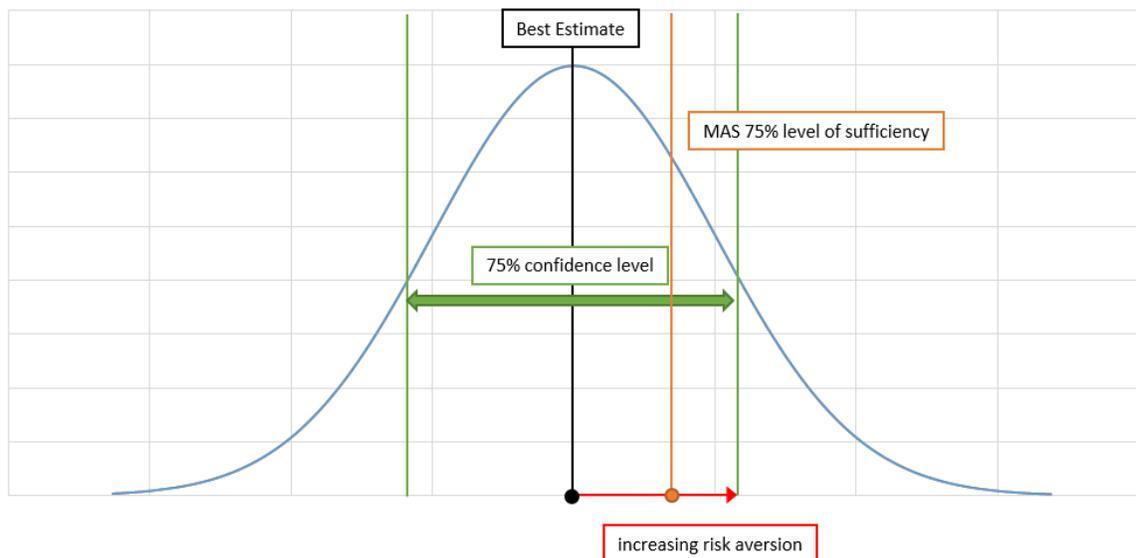
3.5.2.3. Outside of Singapore, Solvency II uses a prescribed cost of capital method, 6%, on the Solvency Capital Requirements which is calculated at 99.5% one-year Value at Risk measure. This method assumes that the additional “capital” required represents the amount that is required to cover the risks arising from holding the technical provisions.

3.5.2.4. In both cases, there exists an additional margin, over and above the best estimate.

3.5.3. Key implementation issues faced by General Insurers:

3.5.3.1. Requirements under IFRS 17

- Both the GMM and the PAA require an entity to hold a risk adjustment when determining both the liability for incurred claims and LRC.
- Explicit financial reconciliations on risk adjustment are required under paragraph 101, 104, 106 and 107. Additional disclosure requirements under paragraph 119 are:
 1. The confidence level used to determine the risk adjustment; or
 2. If confidence level technique is not used, the technique that is used and the confidence level that corresponds to the results of the technique used.
- Using the PAD required under the V&C Regulations as an example, the required provision is 75% level of sufficiency. Assuming losses are normally-distributed, the 75% level of sufficiency results in a risk adjustment at 75% confidence level.



3.5.3.2. The level of granularity at which risk adjustment is determined:

- Separate risk adjustments should be determined for gross risks and reinsurance held.

- The level of granularity is not specified in IFRS 17. However, it may be operationally simpler that the risk adjustment be calculated at the level at which ultimate losses are projected.
- Application Guidance, paragraph B88: Degree of diversification benefits should be considered together with the level of granularity used. For example, if risk adjustment is determined at entity level, separate and additional diversification allowance might not be necessary.
- For proportional reinsurance held treaties, RA provision determined from gross portfolio could be used for reinsurance held RA provision, if it is a direct quota share cession.

3.5.3.3. The methodologies to determine the risk adjustment

- The insurer should use sound actuarial methodologies proposed by the certifying actuary (“CA”) according to the circumstances of each insurer.
- Similar to the determination of actuarial central estimates, the insurer should consider a range of methodologies in estimating the risk adjustment.
- Sufficient documentation is required, including explanation and rationale of the selected methodologies, selected loss distribution under confidence level technique and the use of any external data if applicable.
- Application Guidance, paragraph 119: Methodologies used must be translated into confidence level. Hence, commonly-used methodologies may be easier to translate into a confidence interval. Techniques such as the cost of capital method may not be easily translated. Additional disclosures on the confidence interval are required in order to provide concise and informative disclosures so that users of financial statements can benchmark the entity’s performance against the performance of other entities as per Application Guidance, Paragraph B92.
- Application Guidance, paragraph B91: The risk adjustment should have the following characteristics -

<u>Higher</u> Risk Adjustments	<u>Lower</u> Risk Adjustments
Low frequency and high severity	High frequency and low severity
Contracts with a longer duration	Contracts with a shorter duration
Wider probability distribution	Narrower probability distribution
Less that is known about the current estimate and its trend	More that is known about the current estimate and its trend
Emerging experience increases uncertainty about the amount and timing of cash flows	Emerging experience reduces uncertainty about the amount and timing of cash flows

- Application Guidance, Paragraph B88: Degree of diversification benefits should be considered and methodology should be documented.

3.5.3.4. Confidence level

- The management should decide on the confidence level for the risk adjustment based on the company's risk appetite, CA's own risk assessment and professional judgement, industry benchmark, etc.
- The choice of confidence level should be documented.

3.5.4. Other considerations:

- 3.5.4.1. The allowance for risk adjustment to reflect the entity's degree of risk aversion means that it is possible that the risk adjustment would be different for two entities with the same range of possible outcomes.

3.6. Discounting

3.6.1. Definitions provided by IFRS 17:

- 3.6.1.1. Paragraph 36: An entity shall adjust the estimates of future cash flows to reflect the time value of money and the financial risks related to those cash flows, to the extent that the financial risks are not included in the estimates of cash flows. The discount rates applied to the estimates of the future cash flows described in paragraph 33 shall –
- a) reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts;
 - b) be consistent with observable current market prices (if any) for financial instruments with cash flows whose characteristics are consistent with those of the insurance contracts, in terms of, for example, timing, currency and liquidity; and
 - c) exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts.
- 3.6.1.2. Paragraph 56: If insurance contracts in the group have a significant financing component, an entity shall adjust the carrying amount of the liability for remaining coverage to reflect the time value of money and the effect of financial risk using the discount rates specified in paragraph 36, as determined on initial recognition. The entity is not required to adjust the carrying amount of the liability for remaining coverage to reflect the time value of money and the effect of financial risk if, at initial recognition, the entity expects that the time between providing each part of the coverage and the related premium due date is no more than a year.
- 3.6.1.3. Paragraph 59(b): In applying the premium allocation approach, an entity shall measure the liability for incurred claims for the group of insurance contracts at the fulfilment cash flows relating to incurred claims, applying paragraphs 33–37 and B36–B92. However, the entity is not required to adjust future cash flows for the time value of money and the effect of financial risk if those cash flows are expected to be paid or received in one year or less from the date the claims are incurred.
- 3.6.1.4. The Standard does not require a particular estimation technique for estimating discount rate. The Standard outlined two general principles in determining the discount rate:
- Bottom-up approach - An entity first determines a yield curve in the appropriate currency for instruments that expose the entity to no or negligible credit risk and adjusts it to reflect the illiquidity of the insurance contract compared to the instrument for which market information is available.
 - Top-down approach - An entity first determines a yield curve reflecting the current market return for a reference portfolio of assets and adjusts it for characteristics that are irrelevant for insurance contracts (e.g. duration mismatches, expected credit losses, the market premiums for credit risks).
- 3.6.1.5. Currently, most general insurers estimate the insurance liabilities on an undiscounted basis.
- 3.6.1.6. General insurers typically issue insurance contracts providing coverage over a relatively short period of time i.e. one year. As such, general insurers are likely to adopt the Premium Allocation Approach (“PAA”) for majority of their groups of contracts.
- 3.6.1.7. The primary focus of this paper will be on the key implications and decisions for entities applying the PAA.

3.6.2. Key implementation issues faced by general insurers:

3.6.2.1. Assess the discounting requirements to discount fulfilment cash flows for PAA cohorts

- If contracts in the group have a significant financing component, discounting is required for the liability for remaining coverage. However, significant financing components are not common for general insurance products.
- If future cash flows are expected to be paid or received one year after the date the claims are incurred, discounting is required for the liability for incurred claims

3.6.2.2. Assess the materiality of the impact of discounting to the insurance liabilities and profit

- For entities that do not currently apply discounting on the insurance liabilities, the expected impact is a decrease in the value of insurance liabilities and an increase in equity (when first applying the Standard).
- The magnitude of the impact of discounting on the insurance liabilities will depend on the length of settlement periods, the size of the claims and the discount rate adopted.
- Develop methodology and processes to demonstrate the materiality of discounting
- Develop threshold for materiality.
- Communication with the external auditor.

3.6.2.3. Considerations required if entity chooses to discount its contract liabilities

- Assessment of the operational complexity (such as tracking of historical interest rates, integration with valuation systems) and the need to develop systems and processes to operationalise discounting
- Decision on the appropriate methods to derive discount rate.
- Consideration of the availability of information required to the selected techniques.
- Decision on the accounting policy to present the effects of changes in discount rates either in (1) profit or loss or (2) disaggregated between profit or loss and other comprehensive income.

3.7. Contract Boundaries

3.7.1. Definitions provided by IFRS 17:

3.7.1.1. Paragraph 25: An entity shall recognise a group of insurance contracts it issues from the earliest of the following:

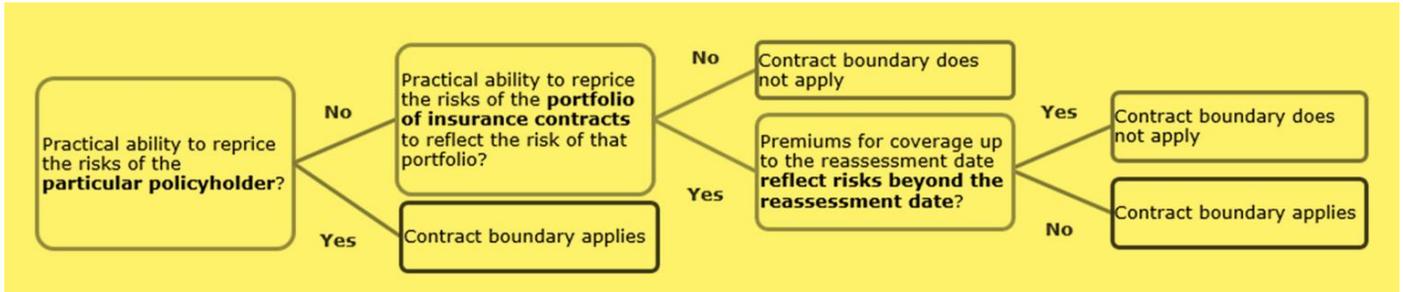
- (a) the beginning of the coverage period of the group of contracts;
- (b) the date when the first payment from a policyholder in the group becomes due; and
- (c) for a group of onerous contracts, when the group becomes onerous.

3.7.1.2. Paragraph 34: Cash flows are within the boundary if they arise from substantive rights and obligations that exist during the period in which the entity can compel the policyholder to pay premiums or the entity has a substantive obligation to provide the policyholder with coverage. I.e. take into account all substantive rights (from contract or law) held by the policyholder.

3.7.1.3. Paragraph 2: Consider all of the substantive rights and obligations that are held by the entity, whether they arise from a contract, law or regulation, but ignore terms that have no commercial substance (i.e. have no discernible effect on the economics of the contract, i.e. take into account all restrictions that have commercial substance).

3.7.1.4. Paragraph 34: A substantive obligation to provide services ends when:

- (a) the entity has the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects those risks; or
- (b) both of the following criteria are satisfied:
- (i) *the entity has the **practical ability to reassess the risks of the portfolio of insurance contracts...** can set a price or level of benefits that **fully reflects the risk of that portfolio; and***
 - (ii) *the pricing of the premiums for coverage up to the date when the risks are reassessed **does not take into account the risks that relate to periods after the reassessment date.***



3.7.1.5. Application Guidance, paragraph B64: When assessing whether the entity has the practical ability to set a price that fully reflects the risks in the contract or portfolio, it shall consider all the risks that it would consider when underwriting equivalent contracts on the renewal date for the remaining coverage. In determining the estimates of future cash flows at the end of a reporting period, an entity shall reassess the boundary of an insurance contract to include the effect of changes in circumstances on the entity’s substantive rights and obligations.

3.7.2. Key implementation issues faced by general insurers:

3.7.2.1. Contract boundary – end of exposure

- It is common for general insurers to offer no claim discounts (“NCD”) in their Motor policies, or other products. If the discount given to the policyholder is provided on renewal, i.e. after the original policy has expired, then this cashflow exists outside of the contract boundary. However, there may be situations where experience adjustments are made at the end of the policy, before expiry. In this case, the experience adjustment cashflow would be included within the contact boundary.

3.8. Reinsurance

Under IFRS 17, reinsurance contracts are required to be accounted for separately from the underlying insurance contracts to which it relates. Whilst an underlying insurance contract may be exposed to the possibility of a significant loss, this risk may not necessarily be transferred to the reinsurer. The reinsurance contract on the other hand, may not expose the insurer to a significant loss, but may be deemed to transfer the reinsured portion of the risk to the reinsurer.²

As such the insurer needs to pay the underlying policyholder in full, rather than reduce the amount based on the expected recovery from the reinsurer.

This guidance note only refers to outwards ceded reinsurance as opposed to inwards reinsurance.

While the IFRS 17 does not state accounting treatment differences between outwards and inwards reinsurance, we note that from the AASB17 point of view, reinsurers should account for inwards business as ordinary contracts of insurance.

3.8.1. Definition provided by IFRS 17 Standards:

3.8.1.1. Appendix A: Definition of Reinsurance Contract –

A reinsurance contract is an insurance contract issued by one entity (the reinsurer) to compensate another entity for claims arising from one or more insurance contracts issued by that other entity (underlying insurance contracts).

3.8.1.2. Recognition

Insurance Contracts	Reinsurance Contracts (Proportionate)	Reinsurance Contracts (Non-Proportionate)
<p>A group of insurance contracts issued is recognised from the <i>earliest</i> of:</p> <p>(A) the beginning of the coverage period of the group of insurance contracts;</p> <p>(B) The date the first payment from a policyholder in the group becomes due; or</p> <p>(C) For a group of onerous contracts, when the group becomes onerous.</p>	<p>A group of proportionate reinsurance contracts held is recognised at the <i>later</i> of:</p> <p>(A) the beginning of the coverage period of the group; or</p> <p>(B) The initial recognition of any underlying insurance contract.</p> <p>A group of proportionate reinsurance contracts will not be recognised until at least one of the underlying insurance contracts have been recognised).</p>	<p>A group of non-proportionate reinsurance contracts held is recognised at the beginning of the coverage period of the group.</p>

3.8.1.3. Paragraph 63-68: Measurement

- Estimation of future cash flows

² Paragraph B19 of IFRS17 and BC298 of the Basis for Conclusions on IFRS 17

The estimates of the present value of future cash flows of reinsurance contracts held must use assumptions consistent with those used to estimate the present value of future cash flows of underlying contracts.

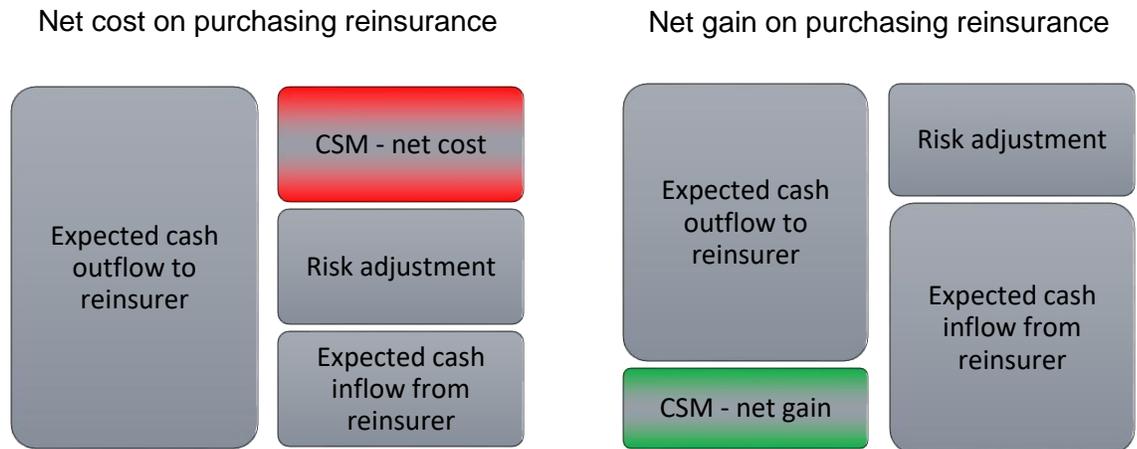
- Risk Adjustment

The risk adjustment for non-financial risk for reinsurance contracts held represents the amount of risk being transferred by the holder of the group of reinsurance contracts to the reinsurer. The reinsurance risk adjustment should be the amount that would make the entity indifferent to entering into the reinsurance contract to mitigate the risks ceded.

Non-performance risk of the reinsurer should be included in the measurement of the future cash flows. For example, reinsurer default risk and risk of dispute in claim liability of the reinsurer.

- Contractual Service Margin

A reinsurance contract held cannot be considered onerous applying IFRS 17. The contractual service margin (“CSM”) for a group of insurance contracts represents the unearned profit the entity will recognize as it provides services in the future. On the other hand, the CSM for a reinsurance contract held represents the cost of purchasing reinsurance. Where the CSM represents a net gain on purchasing reinsurance, this is treated as a reduction in the cost of purchasing reinsurance.



The recognition and allowance for CSM for outwards reinsurance contracts and their interaction with underlying contracts will be considered further in future iterations of this paper.

3.8.2. Key implementation issues faced by general insurers:

3.8.2.1. Grouping

Given a reinsurance contract cannot be deemed onerous under IFRS17, the level of aggregation for reinsurance contracts needs special consideration. Reinsurance contracts held by an insurer are individual in nature and therefore a grouping at the individual contract level is likely to make sense.

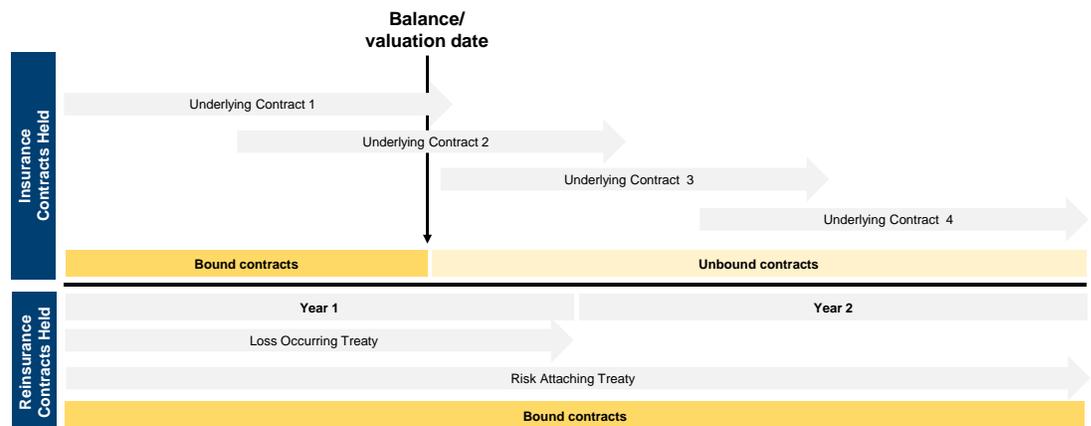
Rather than splitting between onerous and non-onerous, an alternate grouping could be around whether a reinsurance contract expects a net gain at initial inception. In the majority of cases, the insurer should expect a net cost from purchasing the reinsurance. However, in certain circumstances, there may be some contracts for which the insurer expects a net gain. Differentiating these two groups of reinsurance contracts should be considered.

Further risk aggregation should account for the relevant reporting standards, for example in Singapore it should reflect the MAS classes of business as per Form 6 of the returns.

Reinsurance contracts can sometimes cover underlying insurance contracts from different groups / classes, such as whole account quota share or whole account excess of loss.

- Measurement can be done on the whole account reinsurance contract and then allocated across underlying insurance contracts. The insurer may select the allocation methods, such as exposure basis or expected loss basis.
- Where treating it as a single contract does not adequately reflect the substance of the cover, one may consider separating it into different parts.

3.8.2.2. Contract Boundary – End of exposure



In the example above, a risk attaching treaty would not automatically meet the premium allocation approach criterion of having a coverage period of one year or less, given the nature of the treaty. The insurer will then need to assess if it may meet the criterion of reasonably expecting the resulting measurement not to differ materially from the measurement applying the general model.

If the PAA criterion cannot be met, the insurer will have to make assumptions on all cashflows to be met, including those from risks that have yet to be written or bound. This is a change from existing practices for an insurer and would involve new projections and assumptions. These assumptions have to be monitored across time and may affect CSM calculations.

Cash flows are within the contract boundary if:

- they arise from substantive rights and obligations of the entity that exist during the reporting period in which the entity is compelled to pay amounts to the reinsurer or in which the entity has a substantive right to receive services from the reinsurer; and
- the boundary of a reinsurance contract held might include cash flows related to underlying insurance contracts that are expected to be issued in the future.

The second point above may represent a change from the current practice of estimating and accounting for reinsurance that insurers typically follow. The intention of the IASB for including

expected cashflows from contracts that are expected to be issued in the future is to ensure consistency between underlying contracts and the reinsurance contracts held in respect of them. Including expected future cashflows from underlying contracts issued in the future reflects the entity's substantive rights to receive services from the reinsurer related to those future underlying contracts.

3.8.2.3. Mismatch between underlying contracts and reinsurance contracts

Apart from the mismatches caused by different levels of grouping and contract boundary issues discussed above, further mismatches will occur as a result of the standard's requirement that reinsurance contracts are to be valued and accounted for separately from the underlying insurance contracts covered.

- A common scenario of mismatch will be timing issues – significant effects of time value of money leading a contract group to be considered as onerous with losses recognised upfront while the underlying outwards reinsurance contracts (which cannot be onerous) recognizing the recovery benefit much later.
- Differences in cash flow dates of recognition impact discounting (refer to discounting discussion in section 4.4) and the assessment of the risk adjustment (timing risk).
- Currency complications could arise if the underlying contracts are in different currencies to the reinsurance contracts held.
- Any non-alignment of risk transfer and/or timing between direct and reinsurance models will lead to potentially material profit recognition differences, taxation implications and could result in strategic changes in the types of reinsurance used for capital management purposes.

3.8.2.4. Reinsurance structures

A reinsurance contract is a separate legal agreement from the underlying insurance contracts, which means the economics of the reinsurance relationship may differ. This could be in terms of quantum and timing of cashflows, retention of risk as well as features of the reinsurance contract itself.

To the extent some of the reinsurance contracts have variable features such as profit commissions, sliding scale commissions, loss corridors, swings, etc., these impact the reported insurance revenue and claims and therefore the future net cost or gain. However, as these features are dependent on the loss experience, the impact will only become apparent in retrospect and contribute further to the cashflow differences. There may be situations in which certain structures of commission constitute non-distinct investment components and would therefore need to be presented differently in the financial statements.

Furthermore, aggregate or umbrella type covers e.g. coverage that “wrap around” underlying covers or that provide coverage across multiple classes or years can make allocation even more difficult. Contracts with features like portfolio transfers, or commutations, or adverse development covers, or tail covers, are likely to combine multiple years together and require the general approach.

IFRS 17 calculations can be conducted for the whole of the contract, and then allocated across the underlying policies in order to derive a net view of the portfolio. IFRS17 does not specify allocation methodologies, which leaves discretion to choose between exposure / coverage or expected loss techniques.

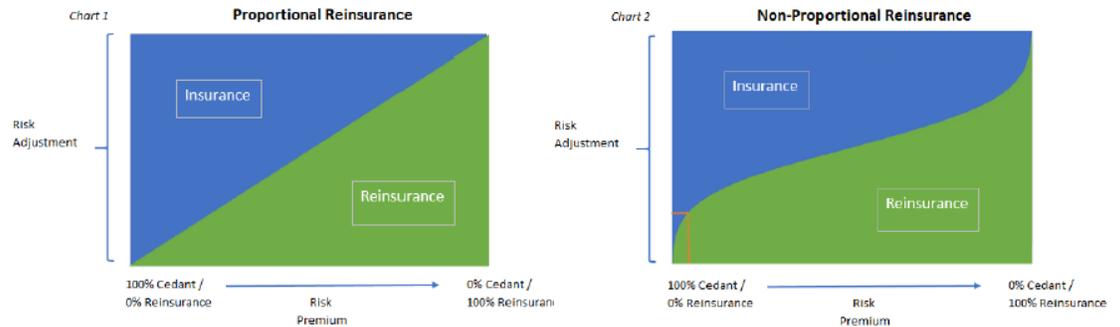
Please note finite reinsurance is not considered here due to lack of risk transfer, and as such fall outside the scope of IFRS17. These are contracts which in legal terms returns all significant risks to the policyholder.

3.8.2.5. Additional risk adjustments

By separating the assessment of the cash flows for contracts issued from the reinsurance contracts held, the risk adjustment for each will similarly require separate assessment. This departs from general market practices for PADs where gross and net (of reinsurance) are considered rather than gross and reinsurance.

For proportional reinsurance, the risk adjustment will generally align to gross risks (particularly when consistent assumptions are applied).

For non-proportional reinsurance (e.g. excess of loss (XoL)), the risk margin will likely represent a higher proportion of its premium due to the higher level of volatility ceded. Risk adjustment for reinsurance contracts will be more complex due to the skewed nature of the distribution of future cash flows.



3.8.2.6. Operational

Insurers may need to redefine existing methods for calculating reinsurance cashflows. Although assumptions used to determine reinsurance cashflows continue to be consistent with those used for underlying insurance contracts, insurers may have to consider:

- Cashflows for projected policies that have yet to be written;
- Specific timing for reinsurance contract settlements. Cashflows from reinsurance contracts held tend to have different timings from that of direct underlying policies due to reinsurance settlement processes. Common practice is that reinsurance contracts between insured and reinsurer tend to follow an annual settlement process;
- Attributing cashflows from different risk types or coverage which may have differing underlying treatments