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IFRS17 for General Insurers

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IFRS 17 for general insurers – general model

IFRS 17 standard has been finalised on 18th May 2017 as a much needed, robust standard. It serves to address the challenges related to reporting under current IFRS 4, which allows a myriad of different accounting policies, thus resulting in a lack of comparability even within insurance groups. Implementation of the standard will be challenging for insurers, companies should be planning how to assess the impact for their organisation.

Background

- IFRS 17 will be introduced effective January 1, 2021. The lead time to January 2021, however is a reflection of the complexities anticipated around the implementation. Explaining the impact of IFRS 17 on performance prior to the adoption of new measurement requirements for insurance contracts may be challenging for some insurers, especially for the general insurers.
- Current IFRS/GAAP for general insurance business where its main business mainly a short term contract, doesn't require risk adjustment and discounting of liabilities for incurred coverage (expired risk). New standard allows the general insurer to choose simplified method to measure liability for unexpired risk subject to eligibility.
- In connection to changes in presentation of the income statement, general insurers will expect to see changes in the emergence of profit over time.

General measurement model

General model comprises of best estimate cash flows, discounting, risk adjustment, and contractual service margin. General model should be applied to all insurance contracts unless the contract is eligible for, and the entity elects to apply the simplified model, premium allocation approach.

Best estimate cash flows is a current estimate of future expected cash flows under contract boundaries. Cash flows are within the boundary of an insurance contract if they arise from rights and obligations that exists during the period in which the policyholder is obliged to provide the policyholder with insurance coverage or other services. The estimates of future cash flows should be adjusted to reflect the time value of money and other financial risks. Risk adjustment under general model should be measured explicitly to reflect associated non-financial risks. The contractual service margin is a component the of the carrying amount of the asset or liability for a group of insurance contracts representing the unearned profit that the entity will recognise as it provides services under the insurance contracts in the group.

	Current IFRS / GAAP	**General model**	**Premium allocation approach**
Liability for remaining coverage (unexpired risk)	UPR less DAC	Contractual service margin Risk adjustment Discounting Estimate of fulfilment cash flows	Premium unearned (less acquisition costs)
Liability for incurred coverage (expired risk)	Undiscounted reserves for past claims (including IBNR)	Risk adjustment Discounting Estimate of fulfilment cash flows	Risk adjustment Discounting Estimate of fulfilment cash flows

IFRS 17 for general insurers – premium allocation approach eligibility

Summary

- General insurers must understand the changes in the new standard compare to current IFRS/GAAP
- On the measurement of insurance liability, general model should be applied as a default model. General model comprises of best estimate future cash flows under contract boundaries, discounting, risk adjustment, and contractual service margin. IFRS 17 allows insurers to use premium allocation approach as a simpler method, subject to eligibility. A group is eligible for the premium allocation approach if:

1. Each contract in the group has a coverage period of one year or less; or
2. Measurement of the liability for remaining coverage for the group using the premium allocation approach is reasonably expected to produce a measurement of the liability for remaining coverage which is not materially different from using the general model

- It is important for general insurer to review their portfolio and do an assessment on the premium allocation approach eligibility, based on more granular group of policies. Key considerations for premium allocation approach eligibility:

Contract boundaries

Grouping

Premium allocation approach eligibility for multi-years contract

Currently many general insurers sell multi-years contract especially for line of business engineering and construction. Current liability for unexpired risks measurement has been done using UPR less DAC because of the cancellation or repricing clause. Multi-years contract most likely not qualify the first criteria shown above. These contracts must be carefully assessed before deciding on what approach can be used to measure the insurance liability.

Decision tree			Typical lines of business impacted
Is the coverage period one year or less?	Yes	PAA is automatically applicable	All annual insurance contracts
No → Do you expect the PAA to produce a measurement of the liability that would not differ materially from the General Model?	Yes	May be possible to construct an argument that PAA is applicable	Two year Property damage policies
	No	General Model is applicable	Multi- year policies

IFRS 17 for general insurers – 4 central areas to think about

How it will impact your business

Premium allocation approach are attracting the general insurers with the prospects of using simpler measurement and it avoids the need to calculate the contractual service margin which is a new playground for some general insurers. Premium allocation approach also allows the general insurers to adopt the standard quickly since it is broadly similar with current approach for unexpired risk (liability for remaining coverage).

The adoption and implementation of new standard will heavily depend on your decisions on certain area below:

Measurement model	Risk adjustment	Discounting option
• Decision to select which model to be used for liabilities measurement • PAA as a simple model eligibility assessment	• How to calculate the risk adjustment • What level of confidence will be targeted	• How to set the discount rates • Taking into consideration of options of effect of changes in discount rates on income statement or other comprehensive income (OCI)

Level of granularity
• What is the impact on both financial and operational aspects of business

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