2—Overview of IFRS 17 requirements

IFRS 17 establishes the requirements that a company must apply in reporting information about insurance contracts it issues and reinsurance contracts it holds. As IFRS 4 does not provide specific requirements for most aspects of the accounting for insurance contracts, companies using IFRS Standards typically have been developing and applying accounting policies for insurance contracts based on local accounting requirements (national GAAP). In this document, these accounting policies are referred to as 'existing insurance accounting practices'.

Section 2—*Overview of IFRS 17 requirements* discusses the key requirements of IFRS 17, including:

- the definition of contracts to which IFRS 17 applies;
- the separation of non-insurance components;
- the recognition and measurement of insurance contracts issued and reinsurance contracts held, highlighting particular requirements for contracts with a variable fee;
- reporting performance of insurance contracts; and
- disclosures.

2—Overview of IFRS 17 requirements

IFRS 17 sets out the requirements that a company must apply in reporting information about insurance contracts. This new IFRS Standard supersedes IFRS 4 and is effective from 1 January 2021.

What is the scope of IFRS 17?

IFRS 17 substantially retains the scope of IFRS 4, so, essentially, the new requirements affect the same population of contracts accounted for when applying IFRS 4. Like IFRS 4, IFRS 17 does not apply to insurance contracts in which the company is the policyholder; the only exception is when those contracts are reinsurance contracts.

IFRS 17 applies to contracts that are:

(a) insurance contracts issued (ie sold);

(b) reinsurance contracts held (ie acquired); or

(c) investment contracts with discretionary participation features issued.

IFRS 17 substantially retains the existing definitions of insurance contracts, reinsurance contracts and investment contracts with discretionary participation features.

Appendix A to this document includes an overview of insurance products commonly issued by insurance companies throughout the world.

IFRS 17 includes definitions that should be used to identify the insurance products to which the new requirements apply.

It is likely that some products regarded as insurance products (based on local law and regulation) will not be treated as insurance contracts accounted for applying IFRS 17.

Insurance and reinsurance contracts

IFRS 17 carries forward from IFRS 4 the definition of an insurance contract and that of a reinsurance contract, together with the related guidance that explains how to apply those definitions.

As in IFRS 4, an insurance contract is defined by the presence of significant insurance risk—that is, a risk, other than a financial risk, transferred from the holder of the contract to the issuer (ie from the policyholder to the insurer).

The Board expects that IFRS 17 will not change conclusions about whether contracts are insurance contracts or reinsurance contracts. Therefore, a contract that is an insurance contract in applying IFRS 4 is expected to be an insurance contract in applying IFRS 17. Companies are unlikely to need to develop internal new guidance and interpretations relating to applying the insurance contract definition in IFRS 17.

Discretionary investment contracts

IFRS 17 also applies to investment contracts with discretionary participation features issued by a company, if the company also issues insurance contracts.[13]

These contracts have similar economic characteristics as insurance contracts (for example, long duration, recurring premiums, the amount or timing of the return is contractually determined at the discretion of the issuer) and they are commonly linked to the same pool of assets as, or share in the performance of, insurance contracts. Applying insurance contracts accounting to these contracts is therefore expected to provide useful information to users of financial statements.

13 Companies that do not issue insurance contracts apply the requirements in IFRS 9 to account for their investment contracts with discretionary participation features.

The definition of an investment contract with discretionary participation features in IFRS 17 is similar to the equivalent definition in IFRS 4.

However, unlike IFRS 4, IFRS 17 applies only to investment contracts with discretionary participation features that are issued by a company that also issues insurance contracts. Other companies apply IFRS 9 to such contracts. Feedback received by the Board indicated that few investment contracts with discretionary participation features are issued by non-insurers. As a result, most of these contracts are expected to continue to be accounted for as insurance contracts rather than as financial instruments applying IFRS 9.

Scope exclusions

Refer to the discussion in Section 3—*Companies affected* about the contracts that can be accounted for applying other IFRS Standards, such as product warranties, financial guarantee contracts and fixed-fee service contracts.

Separate components

An insurance contract typically creates a number of rights and obligations that together generate a package of cash inflows and cash outflows. Some insurance contracts include features in addition to the transfer of significant insurance risk, such as derivatives, deposits and asset management services. These features are known as non-insurance components. Under some circumstances, IFRS 17 requires a company to:

(a) separate the non-insurance components from an insurance contract if a separate contract with the same features would be within the scope of another IFRS Standard; and

(b) account for those non-insurance components applying that other IFRS Standard.

IFRS 17 requirements to separate non-insurance components are summarised in the following table.

Summary of IFRS 17 requirements to account for non-insurance components of an insurance contract separately

Non-insurance component	When they are accounted for separately	Applicable IFRS Standard
Embedded derivatives	If required by IFRS 9[14]	**IFRS 9**
Deposits (investment components or deposit components)	If distinct[15]	**IFRS 9**
Goods and non-insurance services	If distinct[15]	**IFRS 15**

IFRS 17 prohibits the separation of non-insurance components if the specified criteria are not met.

14 IFRS 17 requires a company to apply IFRS 9 to determine whether an embedded derivative should be accounted for separately from an insurance contract.
15 In essence, a non-insurance component in a contract is distinct if: (a) it is not highly interrelated with the insurance component; and (b) a contract with equivalent terms could be sold separately in the same market.

IFRS 17 requirements about the separation of non-insurance components of contracts differ from existing practice mainly by requiring separation of deposits, goods and non-insurance services when specified requirements are met and by prohibiting separation when those requirements are not met.

IFRS 4 requires insurers to separate embedded derivatives and deposits from insurance contracts in some circumstances. However, IFRS 4 does not require insurers to separate from the insurance contract any distinct obligation to provide goods or non-insurance services that are embedded within the insurance contract.

Although IFRS 4 permits insurers to voluntarily change their accounting policies to separate contracts with customers for goods and non-insurance services from their insurance contracts when first implementing IFRS 15, the Board does not expect that many companies have done this (or that they will do so).[16]

Consequently, the Board expects that, when IFRS 17 is first applied, a few goods and non-insurance services embedded within insurance contracts will be accounted for separately for the first time.

IFRS 17 accounting model

IFRS 17 provides a consistent framework for accounting for all insurance contracts issued.

A company is allowed to apply the requirements of IFRS 17 to a group of contracts rather than on a contract-by-contract basis (see Section 5.3—*Key cost reliefs*). In grouping insurance contracts, a company is required to identify portfolios of contracts and to divide each portfolio into:

(a) a group of contracts that are onerous at initial recognition, if any;

(b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and

(c) a group of remaining contracts, if any.

In addition, a group of contracts cannot include contracts issued more than one year apart.

Recognition

IFRS 17 requires a company to recognise a group of insurance contracts it issues from the earliest of the following:

(a) the beginning of the coverage period;

(b) the date on which the first payment from a policyholder is due; and

(c) for a group of onerous contracts, when the group becomes onerous.

Explanations of some terms used

Portfolio of contracts
Insurance contracts that are subject to similar risks and that are managed together.

Onerous contracts
A group of contracts becomes onerous if its estimated cash outflows exceed its estimated cash inflows.

Discount rates
Discount rates reflect the characteristics of the cash flows arising from the group of insurance contracts (for example, the timing, currency and liquidity of the cash flows). They are based on current observable interest rates, with adjustments being made to these observable rates to align them with the characteristics of the group of insurance contracts.

Risk adjustment
The risk adjustment is an explicit adjustment to reflect the uncertainty in timing and in amount of future cash flows.

16 A company is required to apply IFRS 15 from 1 January 2018. Early application is permitted.

Initial measurement

A company issuing insurance contracts assesses the rights and obligations arising from groups of contracts and reflects them net on its balance sheet, on a discounted basis.

All insurance contracts are initially measured as the total of:

1. the fulfilment cash flows; and
2. the contractual service margin, unless the contracts are onerous.

Fulfilment cash flows

The fulfilment cash flows are the current estimates of the amounts that an insurer expects to collect from premiums and pay out for claims, benefits and expenses, adjusted to reflect the timing and the uncertainty in those amounts. The adjustment for uncertainty is called the risk adjustment.

The cash flows of a group of contracts may be affected by cash flows of other groups of contracts as specified in the terms of the contracts. This factor—sometimes referred to as 'mutualisation between contracts'—is considered in the measurement of the fulfilment cash flows.

Contractual service margin

The contractual service margin represents the profit that the company expects to earn as it provides insurance coverage. This profit is recognised in profit or loss over the coverage period as the company provides the insurance coverage.

At initial recognition of the contracts, the contractual service margin is the present value of risk-adjusted future cash inflows less the present value of risk-adjusted future cash outflows. In other words, it is the amount that, when added to the fulfilment cash flows, prevents the recognition of unearned profit when a group of contracts is first recognised.

Onerous contracts

If contracts are onerous, losses are recognised immediately in profit or loss. No contractual service margin is recognised on the balance sheet on initial recognition.

Subsequent measurement

The fulfilment cash flows are measured using current assumptions. Those assumptions are updated at each reporting date, using current estimates of the amount, timing and uncertainty of cash flows and of discount rates.

The way in which changes in estimates of the fulfilment cash flows are treated depends on which estimate is being updated:

(a) changes that relate to current or past coverage are recognised in profit or loss.

(b) changes that relate to future coverage are recognised by adjusting the contractual service margin. However, if the contractual service margin is zero, the changes are recognised in profit or loss.

The contractual service margin is recognised in profit or loss over the coverage period based on the quantity of coverage provided by the contracts in the group and their expected duration.

Interest for the passage of time is accreted on the contractual service margin, using discount rates at initial recognition of the contracts.[17]

Optional simplified approach

A company can use a simplified approach to measure some short-term insurance contracts (see Section 5.3—*Key cost reliefs*).

17 Except for contracts with a variable fee as discussed in the following pages.

Contracts with a variable fee

IFRS 17 has a specific approach for 'insurance contracts with direct participation features'.

Insurance contracts with direct participation features may be regarded as creating an obligation to pay policyholders an amount that is equal to the fair value of the underlying items, less a variable fee for service. Consequently, these contracts provide investment-related services which are integrated with insurance coverage.

Contracts with direct participation features
An insurance contract with direct participation features is a contract that includes all of the following features: (a) the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items; (b) the company expects to pay the policyholder an amount equal to a substantial share of the fair value returns on the underlying items; and (c) the company expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items.

The variable fee:

(a) represents the consideration a company receives for providing investment-related services.

(b) is based on a share in the underlying items for which the value varies over time. Consequently, the variable fee reflects both the investment performance of the underlying items and the other cash flows needed to fulfil the contracts.

The approach for insurance contracts with direct participation features is referred to as the variable fee approach. The variable fee approach modifies the accounting model in IFRS 17 (referred to as the general accounting model) to reflect that the consideration that a company receives for the contracts is a variable fee.

The general accounting model and the variable fee approach measure the fulfilment cash flows in the same way. At initial recognition, there is no difference between the contractual service margin determined applying the general accounting model and that determined applying the variable fee approach. Moreover, subsequent changes in estimates of the fulfilment cash flows that relate to future coverage adjust the contractual service margin.[18] Other changes, including those that relate to current or past coverage, are recognised in profit or loss.

Differences arise for changes in fulfilment cash flows due to changes in discount rates and other financial variables. All such changes are reported in the statement of comprehensive income (profit or loss or other comprehensive income) for the general accounting model. However, in the variable fee approach, the contractual service margin is adjusted to reflect the changes in the variable fee, which includes some changes in discount rates and other financial variables.

An option is available when a company mitigates its financial risks associated with contracts with direct participation features. If such insurance contracts contain complex features, such as minimum payments guaranteed to the policyholder, and the company chooses to use derivatives to mitigate the financial risk created by those features, the company may elect to recognise changes in that financial risk in profit or loss instead of adjusting the contractual service margin. This partially offsets the effect of fair value changes of the relevant derivatives recognised in profit or loss in applying IFRS 9 and reduces potential accounting mismatches.

18 If the contractual service margin became negative, the effect of changes in excess of the contractual service margin would be recognised in profit or loss.

When applying the general accounting model, the interest expense on the contractual service margin is explicitly accreted using rates at the initial recognition of the contracts. In contrast, for contracts with direct participation features, the interest expenses are implicit in the changes in the insurer's variable fee (its share of the underlying items and other cash flows needed to fulfil the contracts).

The following table summarises the key differences between the general accounting model and the variable fee approach.

Differences between the general accounting model and the variable fee approach	
General accounting model	The contractual service margin at initial recognition is updated to reflect changes in cash flows related to future coverage and accreted using interest rates at initial recognition.
Variable fee approach	The contractual service margin at initial recognition is updated to reflect changes in the amount of the variable fee, including those related to changes in discount rates and other financial variables.[19]

Reinsurance contracts held

Insurers typically manage some risks assumed by issuing insurance contracts by transferring a portion of the risk on those underlying insurance contracts to another insurance company, by entering into reinsurance contracts.

IFRS 17 generally requires a company to account for reinsurance contracts held using an approach consistent with that for the underlying insurance contracts.[20] Reinsurance contracts held are accounted for using the general accounting model modified for:

(a) recognition date. A group of reinsurance contracts held is recognised from either the beginning of the coverage period of the group of reinsurance contracts or the initial recognition of the underlying insurance contracts, whichever is the later date, or from the beginning of the coverage period if the reinsurance coverage is not for the proportionate losses of a group of underlying insurance contracts.

(b) estimation of the fulfilment cash flows. For reinsurance contracts held, the fulfilment cash flows reflect the risk of non-performance by the issuer of the reinsurance contract.

(c) measurement of the contractual service margin at initial recognition. Any net gain or loss at initial recognition is recognised as a contractual service margin, unless the net cost of purchasing reinsurance relates to past events, in which case the company is required to recognise the net cost immediately in profit or loss.

Financial performance

A company recognises in the statement of comprehensive income:

(a) an insurance service result, comprising:

(i) insurance revenue; less

(ii) insurance service expenses.

(b) insurance finance income or expenses.

Insurance revenue

Revenue from insurance contracts represents the consideration that a company expects to be entitled to in exchange for services provided under the contracts. It includes the consideration that covers the amount of contractual service margin recognised in profit or loss for the period and the amount of insurance expenses incurred in the period.

Many insurance contracts with investment features include a deposit component—ie an amount paid by the policyholder that is repaid by the insurer even if an insured event does not occur. Deposit components are excluded from profit or loss—ie the collection of a deposit is not revenue and the repayment of that deposit is not an expense.

19 If a company chooses to use derivatives to mitigate the financial risks reflected in insurance contracts, the company can elect to recognise changes in those financial risks in profit or loss rather than by adjusting the contractual service margin.

20 However, a company cannot apply the variable fee approach to its reinsurance contracts issued or to its reinsurance contracts held.

Insurance service expenses

Insurance service expenses reflect the costs incurred in providing services in the period, including incurred claims, and exclude the repayment of deposit components.

Insurance finance income or expenses

IFRS 17 requires a company to account for the fulfilment cash flows and the contractual service margin on a discounted basis that reflects the timing of cash flows. As time passes, the effect of the time value of money reduces and this reduction is reflected in the statement of comprehensive income as an insurance finance expense. In effect, the insurance finance expenses are akin to interest paid on an advance payment and reflects the fact that policyholders typically pay premiums up front and receive benefits only at a later date.

Insurance finance income or expenses also include the effect on the carrying amount of insurance contracts of some changes in financial assumptions (ie discount rates and other financial variables).

A company recognises the effect of those changes in discount rates and other financial variables in the period in which the changes occur. The company can choose where to present this—either in profit or loss, or disaggregated between profit or loss and other comprehensive income. This choice is made by portfolio of contracts (see Section 5.3—*Key cost reliefs*).

The Board expects that a company is likely to choose the option that best corresponds to the accounting for financial assets relating to insurance contracts—ie the option that is most likely to minimise accounting mismatches between investment income (from financial assets) and insurance finance expenses (from insurance contract liabilities) recognised in profit or loss (see Section 7.1—*Interaction with IFRS 9*).

Disclosures

IFRS 17 requires a number of disclosures. They provide additional information about the amounts recognised in the balance sheet and in the statement of comprehensive income, the significant judgements made when applying IFRS 17, and the nature and extent of the risks that arise from issuing insurance contracts.

Explanation of recognised amounts

IFRS 17 requires a company to provide reconciliations between the opening and closing balances of insurance contracts issued and reinsurance contracts held, broken down into the following components:

(a) liabilities for remaining coverage (with separate identification of amounts immediately recognised in profit or loss for onerous contracts) and liabilities for incurred claims; and

(b) the estimates of the present value of future cash flows, the risk adjustment and the remaining contractual service margin.[21]

21 This reconciliation is not required for the liability for remaining coverage of contracts accounted for applying the simplified approach discussed in Section 5.3—*Key cost reliefs*.

IFRS 17 also requires a company to provide:

(a) an explanation of when the remaining contractual service margin is expected to be recognised in profit or loss; and

(b) an analysis of:

(i) the insurance revenue;

(ii) insurance finance income or expenses; and

(iii) new business (ie contracts initially recognised in the period).

Significant judgements

The disclosures required by IFRS 17 about significant judgements made in applying IFRS 17 include:

(a) the methods used to measure insurance contracts and the processes used for estimating inputs to those methods, including quantitative information about those inputs when practicable;

(b) any changes in the above methods and processes, together with an explanation of the reason for each change and the type of contracts affected; and

(c) the yield curve (or range of yield curves) used to discount the cash flows.

If a company uses a technique other than the confidence-level technique for determining the risk adjustment, it is required to disclose a translation of the result of that technique into a confidence level, to allow users of financial statements to see how the company's own assessment of its risk aversion compares to that of other companies.[23]

Nature and extent of risks arising from insurance contracts

The disclosures about insurance and financial risks arising from insurance contracts are similar to the disclosures about financial risks arising from financial instruments in IFRS 7 *Financial Instruments: Disclosures* that are incorporated in IFRS 4 by cross-reference.

These include a sensitivity analysis for insurance risk and for each type of market risk, together with disclosures about:

(a) exposures to risks and how they arise;

(b) objectives, policies and processes for managing risks and the methods used to measure those risks;

(c) concentrations of risk arising from insurance contracts;

(d) the claims development—ie actual claims compared with previous estimates of the undiscounted amount of the claims;

(e) the credit quality of reinsurance contract assets; and

(f) liquidity risk, including a maturity analysis showing the estimated cash flows arising from insurance contracts.

IFRS 17 also requires a company that issues insurance contracts to disclose information about the effect of the regulatory frameworks in which it operates (for example, such information might include minimum capital requirements or required interest rate guarantees). This is in addition to the disclosure requirements included in IAS 1 *Presentation of Financial Statements* for all companies applying IFRS Standards.[24]

23 The confidence-level technique expresses the likelihood that the actual outcome will be within a specified interval. This technique is sometimes referred to as 'value at risk'.

24 IAS 1 requires a company to disclose: (a) information about externally imposed capital requirements; (b) the nature of those requirements; (c) how the requirements are incorporated into the management of capital; and (d) whether during the reporting period the company has complied with any externally imposed capital requirements to which it is subject, and if not, the consequences of such non-compliance.