STAFF PAPER

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Project	**Transition Resource Group for IFRS 17 *Insurance Contracts***
Paper topic	Boundary of reinsurance contracts held

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Introduction

1. We have received a submission about how to read the IFRS 17 *Insurance Contracts* requirements on cash flows that are within the boundary of an insurance contract when applying them for reinsurance contracts held.

2. The objective of the paper is to provide background and an accounting analysis to support discussion at the Transition Resource Group for IFRS 17 (TRG).

Structure of the paper

3. This paper includes the following:

   (a) background information;

   (b) implementation question; and

   (c) review of accounting requirements.

Background information

4. IFRS 17 paragraph 33 states that all future cash flows within the boundary of each contract in a group of insurance contracts shall be included in the measurement of that group.

5. Paragraph 34 of IFRS 17 sets out the following on how to determine whether cash flows are within the boundary of an insurance contract:

   > Cash flows are within the boundary of an insurance contract 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 in which the entity has a substantive obligation to provide the policyholder with services. 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 that contains the contract and, as a result, 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.

6. Paragraph 4 of IFRS 17 states that all references to insurance contracts also apply to reinsurance contracts held with the exception of any reference to insurance contracts issued and specific requirements for reinsurance contracts held set out in paragraphs 60 – 70.

Implementation question

7. The submission asks how to read paragraph 34 of IFRS 17 regarding the boundary of an insurance contract with respect to reinsurance contracts held.

8. The submission notes three different factors that could be considered to impact the assessment of cash flows within the contract boundary for reinsurance contracts held:

   (a) The ability of the reinsurer to exercise rights and have obligations similar to those described by paragraph 34 of IFRS 17.

   (b) The right of the reinsurer to terminate coverage; and

   (c) The right and obligations of the holder of the reinsurance contract (sometimes called cedant).

Review of accounting requirements

9. The staff observe that some of the wording in paragraph 34 does not directly apply to reinsurance contracts held. For example, it refers to an entity’s ability to “compel the policyholder to pay premiums” and “substantive obligation to provide the policyholder with services” which are not applicable for reinsurance contracts held. Under these contracts the entity does not have the ability to compel payment of premiums and the entity does not have an obligation to provide a service.

10. The staff observe that in reading paragraph 34, and other paragraphs of IFRS 17 when relevant, for the purpose of applying them to reinsurance contracts held, the words should be adapted in a way that is appropriate for reinsurance contracts held. For reinsurance contracts held, premiums are paid rather than received and services are received rather than provided. This observation is consistent with paragraph 4 of IFRS 17.

11. The staff view is that the cash flows within the boundary of the reinsurance contract held arise from the substantive rights and obligations of the entity i.e. the holder of the contract. The substantive right is to receive services from the reinsurer. The substantive obligation is to pay amounts to the reinsurer.

12. Consistently, a substantive right to receive services from the reinsurer ends when the reinsurer has the practical ability to reassess the risks transferred to the reinsurer and can set a price or level of benefits for the contract to fully reflect the reassessed risk.

13. Therefore, the staff observe that a substantive right of the reinsurer to terminate the coverage would result in the entity not having the substantive right to receive service. Also, the reinsurer's practical ability to reassess the risks based on the claims experience of the reinsured contracts and to set a premium or level of benefits to fully reflect the reassessed risk means that the entity's substantive right to receive service from the reinsurer ends.

14. One implication of this is that the boundary of a reinsurance contract held could include cash flows from underlying contracts covered by the reinsurance contract that are expected to be issued in the future. This would be the case if the entity has the right to receive insurance services under the reinsurance contract held for those future underlying contracts without the reinsurer having the practical ability to reassess the risks transferred to the reinsurer and set a price or level of benefit to fully reflect the reassessed risk when those future underlying contracts are recognised.

TRG Discussion

Question to TRG members

What are your views on the implementation question presented above?