Simplifying Basics of IFRS 17

Introduction to the Standard

IFRS 17 is the latest international financial reporting standard that impacts all entities whether insurance/ reinsurance or non-insurance that issue insurance contracts. The key objective of IFRS 17 is to have a comprehensive global insurance accounting standard that provides transparent and comparable information to all users of accounts for a better understanding of:

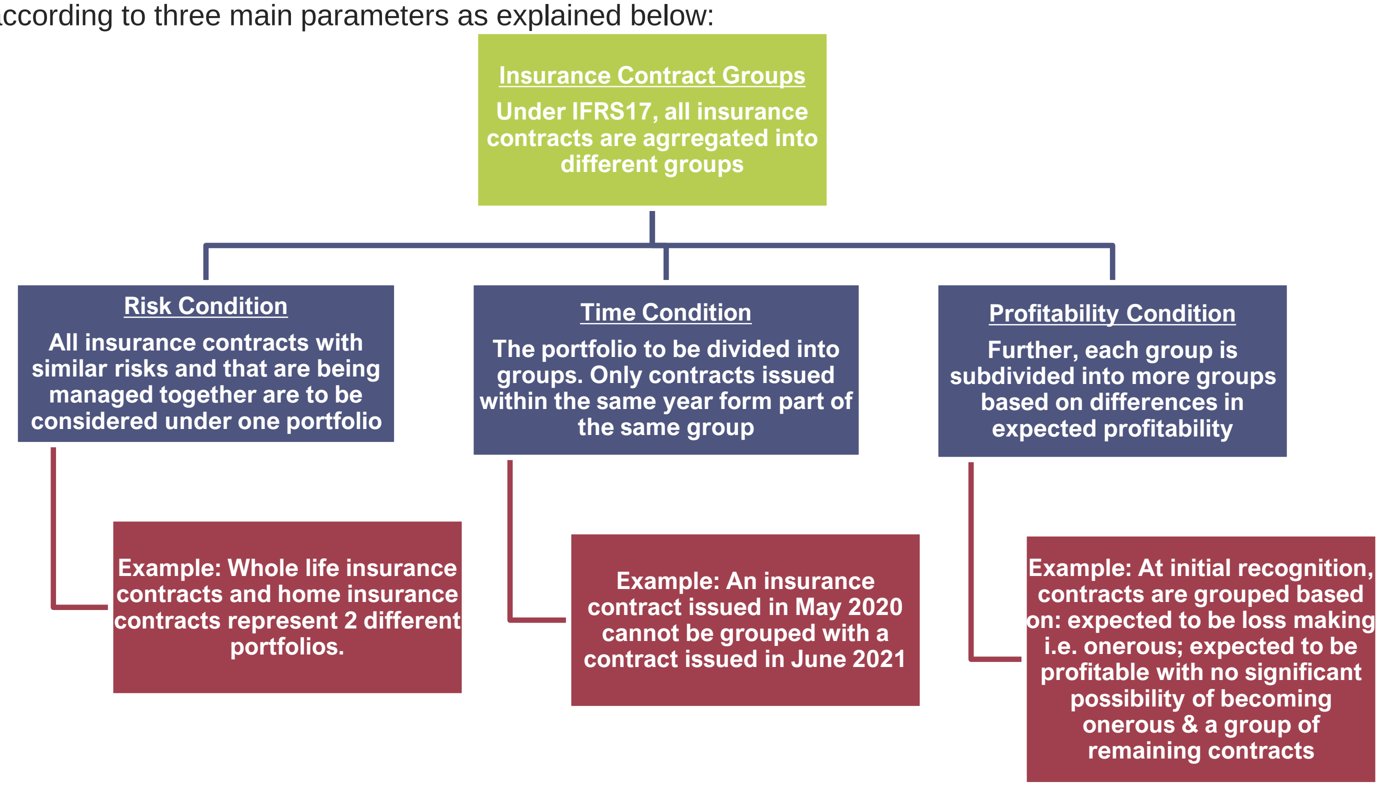
- The financial performance of the entity issuing insurance contracts.
- The various obligations under the insurance contracts are being evaluated using a consistent accounting measurement model.
- The extent of the risk exposure of the entity issuing insurance contracts.

IFRS 17 is also produced to improvise upon the different accounting standards currently followed across the world.

The World of IFRS 17

Some of the key concepts introduced in IFRS17 are:

Insurance Contract Groupings: Under IFRS17, all insurance contracts are aggregated into various groups according to three main parameters as explained below:



Measurement Models & Insurance Contract Liability: Once the groups have been identified, the entity must use a measurement model for reporting the total of the fulfilment cashflows and a contractual service margin for each group. Here,

i. **Fulfilment cashflows (FCFs)** is a present value estimate of the amounts that the entity expects to collect as premiums and pay out in benefits/claims and expenses, including an adjustment for the risk associated with these projected cashflows,

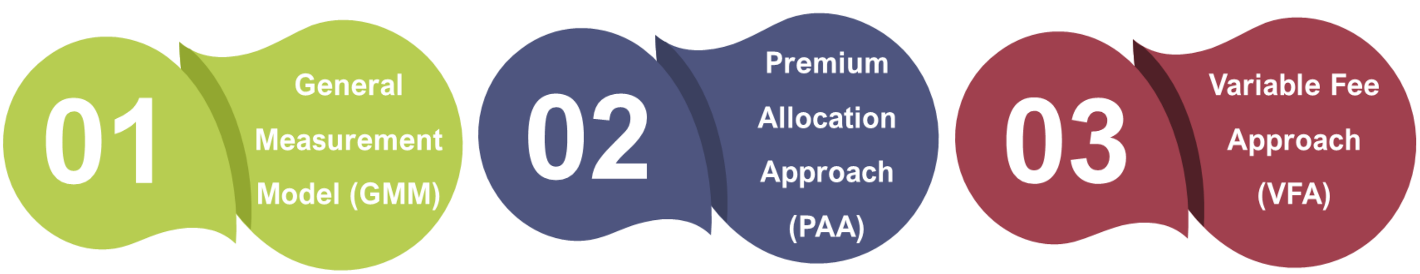
   In other words, <u>**Fulfilment cash flows = Present value of future cashflows + Risk Adjustment**</u>

   and

ii. **Contractual Service Margin (CSM)** is the expected future profit for providing future coverage under the insurance contracts.

   The cashflows underlying the projections for the above two components are referred to as **Insurance Contract Liability (ICL).**

For computing the ICL, IFRS17 defines 3 measurement models that need to be selected by an entity depending on the nature of the underlying groups. These are:

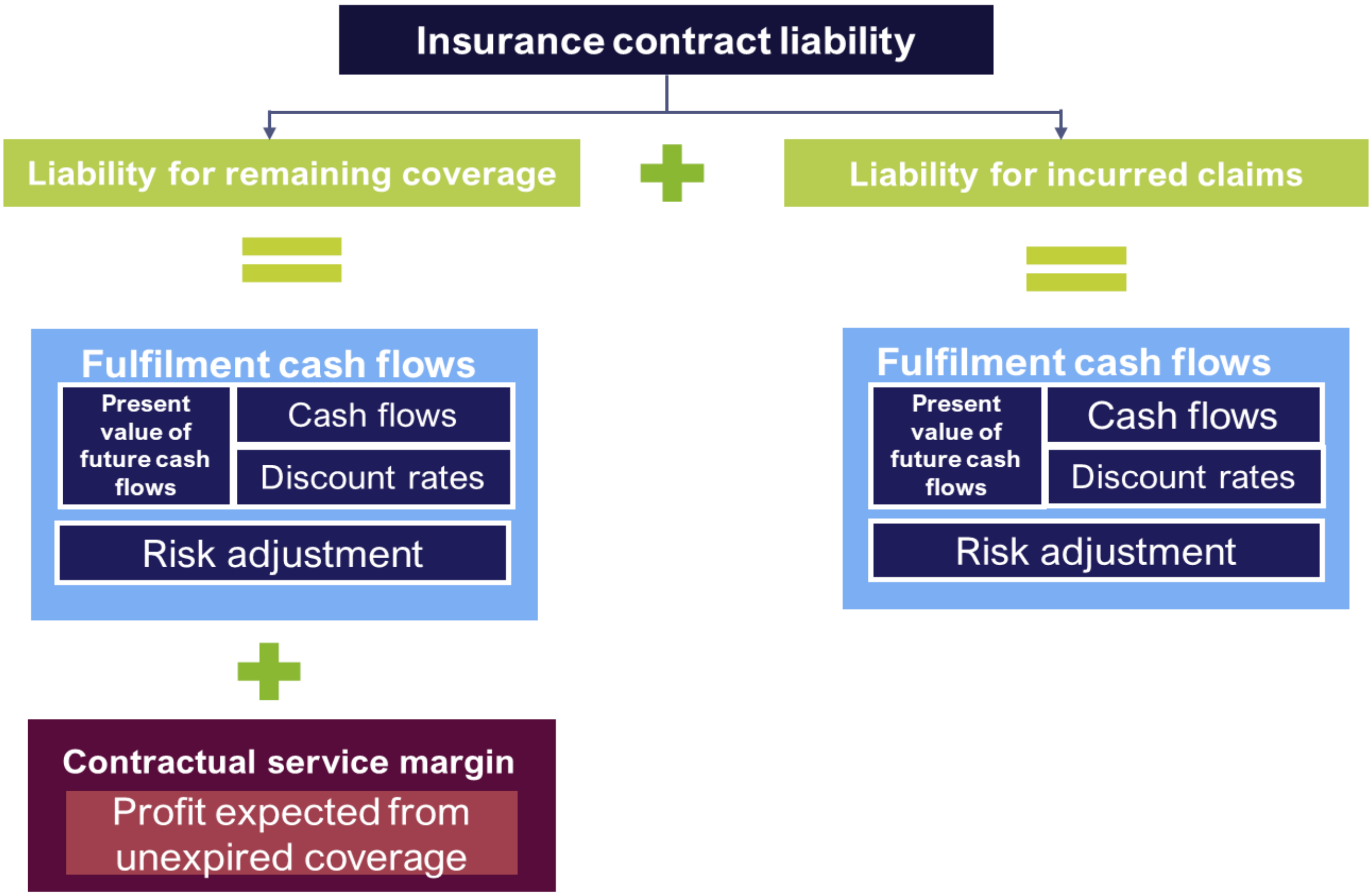


General Measurement Model (GMM) is the default method for ICL calculations. If a company decides to use the other two models, it must justify the same with appropriate reasoning.

Premium Allocation Approach (PAA) is a slightly simplified method for contracts usually less than 1 year in duration. It can be applied for other insurance contracts of the entity using PAA for most of its group provided the entity is able to prove that the results under this approach are similar to GMM with very little difference between the two models.

Variable Fee Approach (VFA) is utilized for insurance contracts with direct participation features. In such contracts, benefits are attached to underlying items and the pay-out is according to the insured's pre-defined share in the underlying items.

Each of the above models projects the ICL with slightly different terms and conditions given the nature of the underlying contracts. The ICL projected under the model is further subdivided as below:



In the above breakdown of ICL, **Liability for Remaining Coverage** (LRC) refers to the liability that is expected to arise of the unexpired portion of the policy, and **Liability for Incurred Claims** (LIC) refers to the liability that arises from claims that have already occurred at a reporting date.

Similarly, the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise from the non-financial risks is maintained in the form of **Risk Adjustment.**

Conclusion

The requirements under IFRS17 demands various changes, such as:

Currently, regulators across the world are planning implementation timelines for their countries, some starting as early as next year. For gaining more insights on IFRS17 or its solutions, please feel free to contact us.

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