IFRS 17 Insurance Contracts

A new perspective on insurance accounting

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“IFRS 17 will give users of financial statements a whole new perspective. For the first time, insurers will be on a level footing internationally. It will open up the ‘black box’ of current insurance accounting.”

“The ways in which analysts interpret and compare companies will change. Increased transparency will give users more insight into an insurer’s financial health than ever before.”

Joachim Kölschbach, KPMG’s global IFRS insurance leader
What’s the issue?

Analysts currently have to **adjust** insurance companies’ financial positions and performance to be able to compare them.

*IFRS 17 increases **transparency** about profitability and will add **comparability**.*
The changes could significantly affect insurers’...
A new, comprehensive accounting model

IFRS 17’s general measurement model (GMM) is based on a fulfilment objective and uses current assumptions.

It introduces a single, revenue recognition principle to reflect services provided.

And is modified for certain contracts.
The general measurement model
Initial recognition

Key components

1. Fulfilment cash flows
   Risk-adjusted present value of future cash flows – e.g. premiums, claims

2. Discounting

3. Risk adjustment

4. Contractual service margin (CSM)
   Represents unearned profit – results in no gain on initial recognition

Net cash outflows result in no CSM – a loss is recognised immediately
Total liability of a group of insurance contracts

Liability for remaining coverage (LRC)
- Fulfilment cash flows related to future services, plus
- CSM (unearned profit) remaining

+ Liability for incurred claims (LIC)
- Fulfilment cash flows for claims incurred, but not yet paid
Subsequent measurement

Changes in current estimates

Fulfilment cash flows

CSM

Financial risk assumptions

Past and current services

Future services

Adjust the CSM

CSM allocation

OCI

Either

P&L

Or

P&L

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Recognising insurance revenue

Insurance revenue is derived from the changes in the LRC for each reporting period, covering...

- Expected insurance claims and expenses
- Risk adjustment
- CSM allocation
- Acquisition cash flows

These items represent a company’s consideration for providing services
Level of aggregation

The **CSM** is determined for **groups** of insurance contracts

- Portfolio
- Annual cohort
- Group

Insurers will need to account for their business performance at a more granular level

IFRS 17 limits offsetting of onerous contracts against profitable ones
Modifications to the GMM
The PAA is an optional, simplified model for measuring the LRC

Total liability of a group of insurance contracts

- Liability for remaining coverage (LRC)
  - PAA replaces the GMM for short-duration contracts
- Liability for incurred claims (LIC)
  - May need to be discounted

Premium is recognised over time as revenue unless release of risk follows a different pattern

While unearned premium is a familiar concept, the revenue recognition pattern could differ
Variable fee approach (VFA)

The approach considers the **variable fee** associated with direct participating contracts.

Obligation to policyholder = Obligation to pay fair value of underlying items - Variable fee

Subsequent measurement – Accounting for changes
- Recognised immediately
- Adjusts the CSM

The VFA reduces the volatility of net results.
For reinsurance contracts held...

The **GMM** and **PAA** still apply, with modifications

The reinsurance contract held is accounted for separately from the underlying direct contract

Reinsurance gain or loss is recognised as reinsurance services are received
Presentation and disclosures
Investment components are excluded from insurance revenue and service expenses.

Entities can choose to present the effect of changes in discount rates and other financial risks in profit or loss or OCI to reduce volatility.
Disclosures

Information should be disclosed at a level of granularity that helps users assess the effects contracts have on…

New disclosures relate to expected profitability and attributes of new business
Transition
Full retrospective approach is required...

... but expedients can be used

Is it impracticable to use a full retrospective approach?

- Yes
  - Either
    - Modified retrospective approach, if possible
    - Fair value approach

- No
  - Full retrospective approach

A company can apply different approaches for different groups
Making the transition

Comparative information is restated

Limited ability to redesignate some financial assets on initial application
Potential accounting changes for insurers
Life insurers

**Significant accounting changes** are almost certain to occur under the new standard

Sources of complexity include…

- Use of current estimates
- Disaggregating changes in LRC
- Tracking the CSM at a group level
Non-life insurers

Accounting for non-life insurers may have similarities to current practice

But major impacts may arise around…

- Qualifying for the PAA
- LIC discounting
- Onerous contracts
Other things to think about

Accounting mismatches may occur but accounting policy choices and transition provisions could reduce them

More consistency and transparency for options and guarantees
Effective date and next steps
Fundamental operational challenges lie ahead and there isn’t much time

You need to…

- Complete an initial assessment
- Review your contracts
- Plan your accounting policy decisions
- Determine your needs for systems, processes and resources
Find out more

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