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Insights into IFRS 17

Subsequent measurement

IFRS 17 'Insurance Contracts' (IFRS 17 or the Standard) establishes a principle-based framework for the recognition, measurement, presentation and disclosure of insurance contracts, based on a current fulfilment value approach. Insurance liabilities are measured as the sum of the present value of future cash flows, an explicit risk adjustment for non-financial risk, and the contractual service margin (CSM) representing unearned profit. The Standard introduces a systematic basis for profit recognition over the coverage period, reflecting the transfer of insurance services, and requires entities to update assumptions at each reporting date. As a result, IFRS 17 enhances consistency, transparency and comparability of financial reporting, while significantly increasing the complexity of measurement and disclosure requirements.

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The carrying amount of a group of insurance contracts at the end of each reporting period is the sum of the liability for remaining coverage (LRC) and the liability for incurred claims (LIC). If the contracts are accounted for under the premium allocation approach, the principles will be discussed in a future article.

At the end of each reporting period the LRC as well as the LIC for a group of insurance contacts being accounted for under the general measurement model (GMM) comprise the following components:

Liability for remaining coverage

- Fulfilment cash flows related to future service allocated to the group of insurance contracts
- CSM applicable to the group of insurance contracts

Liability for incurred claims

- Fulfilment cash flows related to past service allocated to the group of insurance contracts

An entity should then recognise income and expenses for the following changes in the carrying amount of the above liabilities arising from the issuance of insurance contracts:

Financial statement component	Changes in	
	Liability for remaining coverage	Liability for incurred claims
Insurance services revenue	For the reduction in liability because of services provided in the period	Changes made to this type of liability should not be recognised as insurance services revenue
Insurance services expenses	For losses on groups of onerous contracts, and reversals of such losses	For the increase in the liability due to claims and expenses incurred during the period (excluding any investment component) For any subsequent changes in fulfilment cash flows relating to incurred claims and incurred expenses
Insurance finance income or expenses	For the effect of time value of money and the effect of financial risk	For the effect of time value of money and the effect of financial risk

The fulfilment cash flows are measured following the same principles as for initial measurement. The CSM at the end of the period represents the profit in the group of insurance contracts that has not yet been recognised in profit or loss because it relates to future services.

CSM on contracts without discretionary participation feature (DPF)

The approach for measuring the CSM for contracts without discretionary participation feature at the end of the reporting period is illustrated below:

	CSM	Profit or loss	Notes
Carrying amount at the beginning of the period	X		
Effect of any new contracts added to the group	X		
Interest accrued during the period*	X	(X)	* historic rate determined on initial recognition
Changes in fulfilment cash flows related to future service**	X		** exclude: • Increases in fulfilment cashflows > CSM carrying amount, giving rise to a loss or • Decreases in fulfilment cash flows allocated to the loss component of the liability for remaining coverage
Foreign currency gains/losses	(X)	X	
Carrying amount before allocation	X		
Amount recognised as insurance revenue in the period***	(X)	X	*** The allocation is based on the number of coverage units provided in the current period as a proportion of total coverage units in the current and future periods
Carrying amount at the end of the period	X		

Examples of changes in fulfilment cash flows that relate to future services may include:

- experience adjustments from premiums received in the period that relate to future service and related acquisition expenses and taxes
- changes in the risk adjustment that relate to future service, and
- differences arising from the difference between actual investment component payable in the period and the one expected to become payable, etc.

Changes in estimates of cash flows in the liability for claims incurred and changes in assumptions that relate to financial risk are not regarded as relating to future services. Therefore, they do not adjust the CSM for contracts without DPF measured under the GMM. However, changes in the discretionary cash flows of contracts without DPF are regarded as relating to future service, and accordingly adjust the CSM.

Profit or loss ← **Change in assumptions for financial risk** | **Changes in discretionary cash flows** → **CSM**

An entity should use the specification (as explained to the right) to distinguish between changes in the commitment that relate to financial risk from changes that relate to the entity's discretion.

To identify discretionary cash flows, an entity should specify at contract inception the basis on which it will determine its commitment (eg determining a crediting rate based on a fixed interest rate or specified asset returns).

Changes in cash flows

Where an entity cannot distinguish at contract inception between what it is committed to and what it regards as discretionary, it should regard its commitment to be the return implicit in the estimate of fulfilment cash flows at contract inception, updated to reflect current assumptions related to financial risk.

CSM on contracts with DPF

The approach for measuring the CSM for contracts with DPF at the end of the reporting period follows the same logic as outlined above for contracts without DPF. The changes in fulfilment cash flows represent the changes in the entity's share in fair value changes of the underlying items.

A reporting entity must recognise in the profit or loss the combined effect of the changes in fulfilment cash flows (excluding cash flows arising in the period) and the changes in the CSM, and analyse those between insurance services revenue, insurance services expenses and insurance finance income or expenses.

The modifications to the above general measurement approach are referred to as the 'variable fee' approach and will be discussed in a future article.

Recognition of the CSM in the profit or loss

The release of CSM to the profit or loss in each reporting period should reflect the service provided under the group of insurance contracts in that period and should follow the process illustrated below.

Identify coverage units →	Allocate CSM to coverage units →	Recognise in the profit or loss
Based on expected duration and size of contracts in the group	Based on units provided in the current period and expected coverage units in the future	Amount allocated to coverage units provided in the period

Example 1: Allocation of the CSM to the profit or loss

The following assumptions have been made when allocating the CSM to the profit or loss:

- the contracts are of equal size, therefore one unit of coverage is provided under each contract for each year
- the contracts expire in year 3 to the extent the holder has not terminated them earlier.

Analysis	**Year 1 number**	**Year 2 number**	**Year 3 number**
Contracts in force – start of year	100	90	70
Contracts in force – end of year	90	70	0
Coverage provided in the current year	100	90	70
Coverage provided in the current year and expected to be provided in the remaining years***	260	160	70
Percentage of remaining coverage provided in the current year**	38.5%	56.3%	100.0%

	Year 1 CU	**Year 2 CU**	**Year 3 CU**
CSM – start of the year	1,500	923	404
CSM release in the year*	(577)	(519)	(404)
CSM – end of the year	923	404	0

* Year 1 release for the year = CU 1,500 × 38.5% = CU 577
** Year 1 percentage of remaining coverage = 100/260 = 38.5%
*** Year 1 sum of coverage to be provided in each year = CU 100 + CU 90 + CU 70 = CU 260

Practical insight – CSM calculation engine

The CSM implementation poses complex operational challenges and may require significant IT investment, process re-design and changes to data capture and analysis. A CSM calculation engine should:

- 'read' actuarial models for future cash flows
- identify the correct historic discount rates per aggregation cohort for interest accretion
- link to financial records and 'track' recouping of previously recognised losses on onerous contracts
- retranslate for FX rate changes, and
- 'mine' operational and actuarial databases to update remaining units of coverage (based on actual experience and future assumptions). Outwards reinsurance will make the task even more demanding.

How we can help

We hope you find the information in this article helpful in giving you some detail into aspects of IFRS 17. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or visit **www.grantthornton.global/locations** to find your local member firm.

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