May 2017

IFRS® Standards
Project Summary

IFRS 17 *Insurance Contracts*

At a glance

The International Accounting Standards Board (the Board) issued IFRS 17 *Insurance Contracts* in May 2017. IFRS 17 sets out the requirements that a company[1] should apply in reporting information about insurance contracts it issues and reinsurance contracts it holds.

IFRS 17 is effective from 1 January 2021.

IFRS 17 replaces an interim Standard—IFRS 4 *Insurance Contracts*.

IFRS 17 is the first comprehensive and truly international IFRS Standard establishing the accounting for insurance contracts.

With existing accounting for insurance contracts, investors and analysts find it difficult to:

(a) identify which groups of insurance contracts are profit making or loss making; and

(b) analyse trend information about insurance contracts.

When applying IFRS 4, companies are not required to account for insurance contracts in one specific way. Instead, insurance contracts are accounted for differently across jurisdictions and may even be accounted for differently within the same company.

IFRS 17:

(a) provides updated information about the obligations, risks and performance of insurance contracts;

(b) increases transparency in financial information reported by insurance companies, which will give investors and analysts more confidence in understanding the insurance industry; and

(c) introduces consistent accounting for all insurance contracts based on a current measurement model.

1 In this document, the term 'company' refers to an entity that prepares financial statements using IFRS Standards. The term 'insurer' or 'insurance company' refers to an entity that issues insurance contracts as defined in IFRS 17.

IFRS 17—the new approach

IFRS 17 introduces an approach that tackles some challenges in accounting for insurance contracts currently addressed inconsistently when a company applies IFRS 4. Insurance contracts:

(a) often cover difficult-to-measure long-term and complex risks, with uncertain outcomes;

(b) are not typically traded in markets; and

(c) may include a significant deposit component—the amount the insurer is obligated to pay the policyholder regardless of whether the insured event occurs.

Insurance obligations and risks

IFRS 17 requires a company that issues insurance contracts to report them on the balance sheet as the total of:

(a) the **fulfilment cash flows**—the current estimates of amounts that the insurer expects to collect from premiums and pay out for claims, benefits and expenses, including an adjustment for the timing and risk of those cash flows; and

(b) the **contractual service margin**—the expected profit for providing future insurance coverage (ie unearned profit).

The measurement of the fulfilment cash flows reflects the current value of any interest-rate guarantees and financial options included in the insurance contracts.

To better reflect changes in insurance obligations and risks, IFRS 17 requires a company to update the fulfilment cash flows at each reporting date, using current estimates that are consistent with relevant market information.

Changes in insurance obligations due to changes in the economic environment (such as changes in interest rates) will be reflected in an insurer's financial statements in a timely way.

IFRS 17 will therefore provide current updated information about the effect of insurance contracts on a company's financial position and risk exposure, as well as transparent reporting of changes in insurance obligations.

IFRS 17 measurement model

Present value of future cash flows + Risk adjustment + Unearned profit (contractual service margin) = **Insurance obligations** (insurance contract liabilities reported on the balance sheet)

Fulfilment cash flows

Insurance performance

IFRS 17 requires a company to provide information that distinguishes two ways insurers earn profits from insurance contracts:

(a) the insurance service result, which depicts the profit earned from providing insurance coverage; and

(b) the financial result, which captures:

    (i) investment income from managing financial assets; and

    (ii) insurance finance expenses from insurance obligations—the effects of discount rates and other financial variables on the value of insurance obligations.

When applying IFRS 17, changes in the estimates of the expected premiums and payments that relate to future insurance coverage will adjust the expected profit—ie the contractual service margin for a group of insurance contracts will be increased or decreased by the effect of those changes.

The effect of such changes in estimates will then be recognised in profit or loss over the remaining coverage period as the contractual service margin is earned by providing insurance coverage.

If the amounts that the insurer expects to pay out for claims, benefits and expenses exceed the amounts that the insurer expects to collect from premiums, either at the inception of the contracts or subsequently, the contracts are loss making and the difference will be recognised immediately in profit or loss.

A timely recognition of losses from insurance contracts and a recognition of profits as insurance coverage is provided will provide important information about the sustainability and future profitability of companies issuing insurance contracts.

Insurance revenue

IFRS 17 requires a company to report as insurance revenue the amount charged for insurance coverage when it is earned, rather than when the company receives premiums.

In addition, IFRS 17 requires that insurance revenue excludes the deposits that represent the investment of the policyholder, rather than an amount charged for services. Similarly, IFRS 17 requires that companies present deposit repayments as settlements of liabilities rather than as insurance expenses.

The requirements in IFRS 17 for the recognition of revenue are consistent with the recognition of revenue for most contracts with customers in other industries and for many short-term insurance contracts today. In contrast, those requirements differ from accounting practices applied today for many long-term insurance contracts.

Useful information in profit or loss

The example on the following page shows how an insurer's profit or loss prepared in applying IFRS 17 will provide more useful information for users of financial statements.

Example of profit or loss applying IFRS 4

In this table, amounts are denominated in 'currency units' (CU)	Year 1 CU	Year 2 CU	Year 3 CU	Total CU
Premiums[2]	15,000	–	–	**15,000**
Incurred claims and other expenses	(170)	(171)	(18,080)	**(18,421)**
Change in insurance contract liabilities	(16,048)	(744)	16,792	**–**
Investment income[3]	1,500	1,281	1,677	**4,458**
Profit or loss	**282**	**366**	**389**	**1,037**

This example illustrates a common method of presentation in profit or loss for a group of contracts when applying IFRS 4. Because of the wide variety of practices to account for insurance contracts when applying IFRS 4, the presentation in this example may not be representative of any specific practice of a company or jurisdiction.

Example of profit or loss applying IFRS 17

	Year 1 CU	Year 2 CU	Year 3 CU	Total CU
Insurance revenue	320	339	386	**1,045**
Incurred claims and other expenses	(8)	–	–	**(8)**
Insurance service result	**312**	**339**	**386**	**1,037**
Investment income	1,500	1,281	1,677	**4,458**
Insurance finance expenses	(1,500)	(1,281)	(1,677)	**(4,458)**
Net financial result	**–**	**–**	**–**	**–**
Profit or loss	**312**	**339**	**386**	**1,037**

This example illustrates two significant changes for a group of 100 insurance contracts. In particular, this example illustrates that IFRS 17:

(a) removes the existing common practice of reporting premiums both as income and, effectively, as expenses when written or due (as part of a line for 'change in insurance contract liabilities')—insurance revenue reflects the services provided, the time value of money on premiums (CU4,458) and excludes deposits (CU18,413), as is the case for any other industry (total insurance revenue = CU15,000 + CU4,458 − CU18,413 = CU1,045); and

(b) enables companies to present the two main drivers of profit separately—namely the 'insurance service result'[4] and the 'net financial result'—to explain the profitability of a group of insurance contracts.

2 This illustration assumes that:
(a) each policyholder pays a single premium of CU150 at the beginning of the coverage period of three years.
(b) the insurer purchases a specified pool of assets (the fund) and measures the pool at fair value through profit or loss.
(c) beneficiaries of the insurance contracts will receive either: (i) CU170 or the value of the investment in the fund if it is higher, if the policyholder dies during the coverage period. The insurer expects, at initial recognition, that one policyholder will die at the end of each year and claims are settled immediately; or (ii) the value of the investment in the fund at the end of the coverage period if the policyholder survives until the end of the coverage period.

3 When applying IFRS 4, some companies present in profit or loss a sub-total line named 'total revenue'. Some companies include premiums only in that sub-total line. Other companies include the sum of premiums and investment income in that sub-total line.

4 When applying IFRS 17, for most companies, the insurance service result will be a new metric comprising insurance revenue less insurance service expenses.

A consistent Standard providing updated information

IFRS 17 is a comprehensive, truly international IFRS Standard

Most stakeholders, including insurers, agree about the need for a common global insurance accounting standard, even though opinions vary as to what it should be.

IFRS 4 is an interim Standard. It does not prescribe the measurement of insurance contracts. Instead it allows companies to continue to use different practices, often based on local accounting requirements (national generally accepted accounting principles—GAAP), for the measurement of their insurance contracts.

As a result, insurers currently use a wide range of accounting practices for reporting financial information on a key aspect of their business.

To illustrate with an example: an insurance company reporting the same set of results, but using the GAAP of two jurisdictions, reported the differences illustrated in the table.

Differences IFRS 4 permits

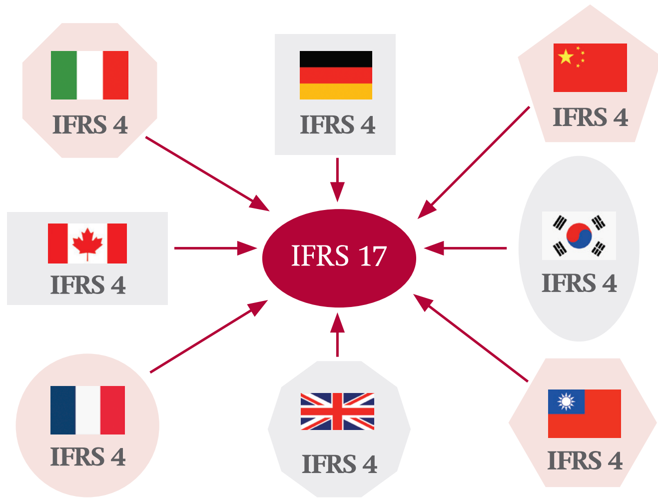
(in millions of currency units)	The same insurance company		
	Measured using GAAP A (current value)	Measured using GAAP B (non-current value)	Differences
Revenue	17,248	13,156	(24%)
Net income	949	1,303	37%
Total equity	12,851	13,277	3%

GAAP A and GAAP B represent national GAAP applied in leading insurance markets and currently used by insurers as a basis for developing their insurance accounting policies when applying IFRS 4.

GAAP A requires the use of updated assumptions for the measurement of insurance obligations, as does IFRS 17 (ie a current value measurement).

Consequently, when insurance companies first apply IFRS 17, they will move to one consistent new accounting framework for their insurance contracts but starting from different points.

Moving to IFRS 17 from different points[5]



Generally, for any new Standard, the effect of changes in accounting requirements varies by company and by jurisdiction, but with IFRS 17, the variability will be considerably more pronounced. This is because, even for identical insurance contracts, different accounting practices currently apply.

5 Jurisdictions shown in the picture on this page represent the jurisdictions—with insurance companies using IFRS Standards to some extent—with the largest amount of insurance premiums written in 2015 according to 'World insurance in 2015: steady growth amid regional disparities', Swiss Re, *sigma No 03/2016*.

IFRS 17 provides updated information for all insurance contracts

Some existing insurance accounting practices fail to adequately reflect the true underlying financial positions or performance arising from insurance contracts. For example, some insurers may measure insurance contracts:

(a) using information that reflects only the insurer's expectations when it entered into the insurance contracts, possibly decades previously, without subsequently updating those expectations; and/or

(b) reflecting incomplete information about the current value of complex features embedded in insurance contracts, such as financial options and interest-rate guarantees.

It is likely that the changes introduced by IFRS 17 will affect insurance companies operating in different jurisdictions differently, depending on the insurance accounting practices currently used by companies applying IFRS 4.

For example, today, many insurers discount the future cash flows from long-term insurance contracts using discount rates that are not updated after contract inception (ie historical rates). However, some insurers use current discount rates, and some multinational insurers use a mix of rates, adopting different accounting practices for insurance contracts issued in different jurisdictions—ie they measure some contracts using current rates and others using historical rates.

When applying IFRS 17, all insurance companies will use current discount rates to measure their insurance contracts. Those discount rates will reflect the characteristics of the cash flows arising from the insurance contract liabilities, while many companies today use discount rates based on the expected return on assets backing the insurance contract liabilities.

Although the current rates used in applying IFRS 17 may be determined differently to existing practices in some jurisdictions, the change in rate will generally be far less significant for the companies using current rates today.

As illustrated by the following table for a sample of companies, the use of current discount rates required by IFRS 17 will represent a significant change for many but not for all insurance companies.

Discount rates used in 2015 for a sample of companies[6]

Type of rates	Number of companies	
	IFRS 4	IFRS 17
Current rates	31	72
Historical rates	25	–
Mix of rates	16	–
Total	**72**	**72**

6 Analysis based on the information included in the 2015 annual reports of a sample of 72 listed insurance companies using IFRS Standards.

Better information about profitability

Some insurers already measure insurance contracts at current value for regulatory purposes. However, the primary objectives of many regulatory frameworks are to protect consumers, ensure availability of insurance products and support economic stability, rather than to provide useful information to users of general purpose financial statements. Consequently, many prudential frameworks are not designed to provide performance reporting metrics. They focus on capital required.

IFRS 17 will provide useful information about the current and future profitability of insurance contracts.

Differences in profitability among insurance contracts provide important information about the sustainability and future profitability of a company. This information will significantly improve the transparency of reporting for insurance contracts and provide important additional information for investors and other users of financial statements for their decision-making.

In addition, IFRS 17 requires a company to provide an explanation of when it expects to recognise in profit or loss the contractual service margin that remains on the balance sheet at the end of the reporting period. This explanation will provide information about the expected future profitability of insurance contracts for providing insurance coverage.

When applying IFRS 17, a company will recognise in profit or loss for a group of contracts:

(a) the expected profit for providing coverage as the coverage is provided over time; and

(b) the expected losses as soon as the company determines that losses are expected (at inception or subsequently).

To make differences in profitability among insurance contracts visible, IFRS 17 requires a company to distinguish groups of contracts expected to be loss making from other contracts.

The following paragraphs describe how a company will group contracts.

1 Portfolios of insurance contracts

When applying IFRS 17, a company will first identify portfolios of insurance contracts.

A portfolio is a set of contracts subject to similar risks and managed together. For example, whole-life insurance contracts, annuities and car insurance contracts represent three different portfolios of contracts.

2 Groups of insurance contracts

Once the company has identified portfolios of contracts, it will divide each portfolio into groups considering differences in the expected profitability of the contracts.

Only contracts issued within the same year can be included in the same group—a contract issued in May 2021 cannot be grouped with a contract issued in June 2022, for example.

For contracts that at initial recognition are expected to be loss making (ie onerous), a company will recognise losses immediately in profit or loss. So losses and profits will not be offset by grouping together loss-making contracts and profit-making contracts.

For contracts that at initial recognition are expected to be profitable, the company will recognise the expected profit as it provides the insurance coverage. The expected profit will be allocated to two groups:

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

(b) a group of remaining contracts, if there are any.

IFRS 17 permits a company to have more groups of insurance contracts than the minimum specified.

For example, several groups of contracts could be created for accounting purposes if the company's internal reporting provides information that distinguishes at a more granular level the different possibilities of contracts becoming onerous after initial recognition.

The grouping requirements in IFRS 17 include an exemption for economic differences that arise as a result of regulatory restrictions. For example, in some jurisdictions, local regulations may prohibit a company from charging different premiums to policyholders because of a specific characteristic, such as gender and age. Such local regulations prevent the company from reflecting the risk arising from a characteristic of a particular policyholder in the price charged to that policyholder. When the reason for the difference in profitability is such regulations, IFRS 17 allows the company to include such contracts in the same group even though their expected profitability is different.

Annual cohorts

The following example illustrates the rationale for the requirement in IFRS 17 to group together only contracts issued within the same year—ie annual cohort requirement.

Suppose a company writes the following contracts:

(a) in Years 1–2, five-year contracts with premiums of CU100 and unearned profit of CU10; and

(b) in Years 3–4, five-year contracts with premiums of CU100 and unearned profit of CU2.

Without the annual cohort requirement:

- the unearned profit of contracts written in Years 1–2 would persist beyond Year 6 because the profitability of the contracts written in Years 1–2 is averaged with the lower profitability of contracts written in Years 3–4 and recognised over Years 3–9; and
- the information about the change in profitability would not be reflected in financial statements in a timely way.

IFRS 17 and volatility

A company should promptly recognise in its financial statements the effects of changes in economic conditions on insurance contracts. Accordingly, IFRS 17 requires that a company update the measurement of insurance obligations at each reporting date, using current estimates of the amount, timing and uncertainty of cash flows and of discount rates.

If an insurer's assets and liabilities are economically matched and are measured using current value principles, the insurer's financial statements would not show volatility arising from economic or accounting mismatches.

Therefore, when a company measures assets backing insurance contracts at fair value, measuring insurance obligations using current estimates consistent with relevant market information reduces accounting mismatches. IFRS 17 offers options to reduce most accounting mismatches.

Consequently, when a company applies IFRS 17, the volatility in the amounts recognised in profit or loss is expected to mainly reflect the effect of changes in economic conditions.

The following paragraphs describe the specific features of IFRS 17 that reduce volatility.

1 Not all changes in estimates will immediately affect profit or loss

When applying IFRS 17, a company will recognise only some changes in insurance contract liabilities immediately in profit or loss.

The company will treat changes in estimates of future cash flows differently, as follows:

(a) changes that relate to future insurance coverage will be recognised by adjusting the unearned profit of the group of contracts affected by changes on the balance sheet; and

(b) changes that relate to past insurance coverage will be recognised in profit or loss.

Economic and accounting volatility

The term volatility is often used to refer to both economic and accounting mismatches.

An **economic mismatch** arises if the values of assets and liabilities respond differently to changes in economic conditions.

Transparency requires that economic mismatches are fully reflected in a company's financial statements.

An **accounting mismatch** arises if changes in economic conditions affect the value of assets and liabilities to the same extent, but the carrying amounts of those assets and liabilities do not respond in the same way to those economic changes because they are measured on different bases.

Accounting mismatches distort a company's financial position and performance and therefore should be eliminated where possible.

❷ Variable fee approach

Some insurance contracts have returns based on the fair value of underlying items, such as ordinary shares. Such contracts are called 'insurance contracts with direct participation features'.

The insurer and its policyholders share those returns, which are affected by market-driven changes in the fair value of the shares.

IFRS 17 has a specific approach—the 'variable fee approach'—for accounting for insurance contracts with direct participation features. This approach enables insurers to recognise some changes in insurance contract liabilities due to changes in returns by adjusting the unearned profit on the balance sheet, rather than in profit or loss.

❸ Option for risk mitigation

Accounting mismatches may arise, for example, if an insurer:

(a) holds derivatives to manage the risk arising from guarantees embedded in insurance contracts;

(b) recognises the effect of changes in the fair value of those derivatives in profit or loss; and

(c) does not recognise the effect of changes in the value of those guarantees in profit or loss (ie using the variable fee approach).

A choice is available in IFRS 17 when a company mitigates the financial risks of insurance contracts with direct participation features using derivatives.

The company may choose to recognise changes in financial risk created by complex features in such insurance contracts, such as minimum payments guaranteed to the policyholder, in profit or loss, instead of adjusting the unearned profit as normally required by the variable fee approach.

The recognition of changes in that financial risk in profit or loss partially offsets the effect of fair value changes in the relevant derivatives that are recognised in profit or loss and reduces potential accounting mismatches.

❹ Option for the presentation of changes in financial assumptions

Changes in insurance contract liabilities may be the consequence of changes in financial assumptions (ie discount rates and other financial variables).

When applying IFRS 17, a company will recognise the effect of some changes in financial assumptions in the period in which the changes occur. However, the company will choose where to present this effect—either in profit or loss, or disaggregated between profit or loss and other comprehensive income. The choice will be made individually for each portfolio of insurance contracts.

The flexibility in the presentation of the effects of changes in financial assumptions provided by IFRS 17 will allow a company to align the accounting treatment of each portfolio of insurance contracts with the accounting treatment of the assets that back that portfolio.

The company is likely to choose the option that minimises accounting mismatches between investment income from financial assets and insurance finance expenses from insurance contract liabilities.

For example, if an insurer mainly holds financial assets measured at fair value and recognises in profit or loss changes in fair value, the insurer is likely to also present all changes in insurance contract liabilities from financial assumptions in profit or loss. The changes in financial assumptions might result in a loss on assets being partially offset by a gain on liabilities with a reduced overall effect on profit or loss.

Implementation support

Mandatory effective date

IFRS 17 is effective for annual periods beginning on or after 1 January 2021.

A company can choose to apply IFRS 17 before that date but only if it also applies IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*.

IFRS 17 includes several transition reliefs to assist a company in applying IFRS 17 for the first time.

For example, a company is not required to account for its insurance contracts as if IFRS 17 had always been applied if this is impracticable. Instead, a company can use either a modified retrospective approach or a fair value transition approach.

In addition, IFRS 17 permits a company that applied IFRS 9 at an earlier date to reassess classifications of financial assets (ie how they are measured) applying IFRS 9 based on facts and circumstances that exist at the date of initial application of IFRS 17.

Implementation challenges

IFRS 17 introduces a fundamental change to existing insurance accounting practices for some companies. Many concepts in IFRS 17 may be new to some companies.

To reflect different risks in the measurement of various types of insurance contracts, some requirements in IFRS 17 are arguably complex. Companies will incur significant operational costs applying the requirements in IFRS 17, including for the development of systems.

Companies will approach the transition to the new requirements from many different perspectives given that IFRS 4 essentially grandfathered any national GAAP.

Consequently, the Board has planned many activities to support the implementation of IFRS 17, including the establishment of a transition resource group for discussing possible implementation questions.

Tools to support implementation

In addition to the materials accompanying IFRS 17, including the *Illustrative Examples*, the Board has planned to make available:

(a) webcasts introducing the new Standard and focusing on specific requirements; and

(b) other materials for investors, regulators and national standard-setters.

The IFRS 17 implementation page[7] on the IFRS Foundation website is updated regularly and provides access to webcasts and other supporting materials, documents prepared by the staff for discussion at public meetings, information about the transition resource group, as well as information about conferences focused on the implementation of IFRS 17.

To stay up to date with the latest developments on IFRS 17 and to sign up for email alerts, please visit the project homepage on go.ifrs.org/insurance_contracts.

7 go.ifrs.org/IFRS-17-implementation.

Important information

This Project Summary has been compiled by the staff of the IFRS Foundation for the convenience of interested parties. The views within this document are those of the staff who prepared this document and are not the views or the opinions of the Board and should not be considered authoritative in any way. The content of this Project Summary does not constitute any advice.

Official pronouncements of the Board are available in electronic format to eIFRS subscribers. Publications are available for ordering from the IFRS Foundation website at www.ifrs.org.

Other relevant documents

IFRS 17 ***Insurance Contracts***—specifies the requirements for the accounting for insurance contracts.

Basis for Conclusions on IFRS 17—summarises the Board's considerations in developing the requirements in IFRS 17.

Illustrative Examples on IFRS 17—illustrate aspects of IFRS 17 but provide no interpretative guidance.

Effects Analysis on IFRS 17—describes the likely costs and benefits of IFRS 17.

Feedback Statement on IFRS 17—summarises feedback on the proposals that preceded IFRS 17 and the Board's response.

Notes

Notes

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