(RE)INSURANCE CONTRACT MEASUREMENT: IFRS17 VS. SOLVENCY II

Maroš Kuzmiak

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Presenter

Maroš Kuzmiak

Risk Manager

VIG RE zajišťovna, a.s.

m.kuzmiak@vig-re.com

Maroš is a risk manager at VIG Re risk management team with the primary responsibility of quantification of risks amongst other in areas related to Solvency II capital requirement calculations as well as ORSA modelling. Previously, he had worked in the Big4 as an actuarial manager with focus on IFRS 17 implementation projects, primarily for non-life (re)insurance companies across Europe.

Maroš holds a master’s degree in financial and insurance mathematics from Charles University.

1. Overview
2. Grouping of contracts
3. Initial recognition
4. Liability measurement
5. Reinsurance held
6. Presentation and disclosures
7. Market updates on IFRS 17
8. Worked examples

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OVERVIEW

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Overview

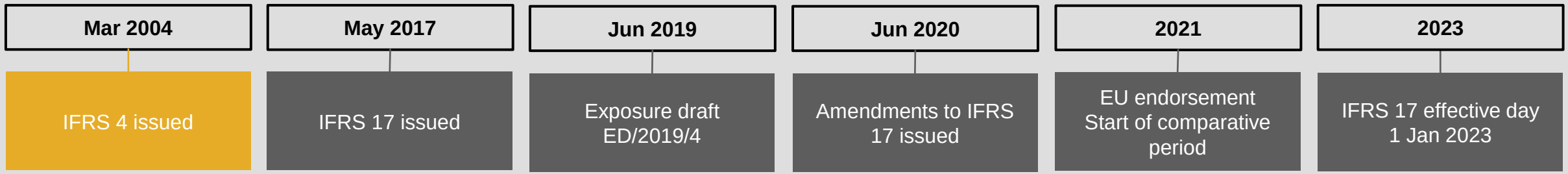
Introduction to IFRS 17

Objectives of the standard

- Consistent accounting for (re)insurance contracts
- Reflect economic changes in timely and transparent way
- Provide improved information about current and future profitability
- Improve comparability
- More transparent and useful information

Key highlights

- A more complex measurement model under IFRS 17 introduces **greater levels of system complexity and cost**
- Changes to financial statement presentation will drive **new key performance indicators** and MI requirements
- Enhanced disclosures requirements will increase **transparency of reserve adequacy and quality of earnings**



Overview

Introduction to Solvency II

The Solvency II regulatory framework is built on a three-pillar structure:

- Pillar I sets the quantitative requirements i.e. the assets and liabilities valuation and capital requirements.
- Pillar II sets the qualitative requirements, including governance and risk management of the undertakings and the Own Risk and solvency Assessment (ORSA).
- Pillar III sets the supervisory reporting and public disclosure.

It is worth pointing out this presentation considers Solvency II requirements exclusively related to valuation of the technical provisions.

Main features of Solvency II

Market consistent	Risk-based
Proportionate	Group supervision

Overview

Nature and purpose of frameworks

	IFRS 17	Solvency II
Developed by	International Accounting Standards Board (IASB)	European regulatory bodies
Application	Fiscal years starting at 1 January 2023	From 1 January 2016 onwards
Framework and purpose	For the preparation of financial statements under IFRS. The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions	Addresses capital, risk management and disclosure requirements. Focused on measuring financial position of the insurance company and thus there is no income statement
Applicable to	All entities who have adopted IFRS	Insurance and reinsurance companies and groups (with limited exceptions for small insurers) headquartered within the European Union

Overview

Nature and purpose of frameworks (cont'd)

	IFRS 17	Solvency II
Main users	Aimed at a wide range of stakeholders	Aimed primarily at needs of supervisor (e.g. protecting policyholder interests, financial stability) and policyholders
Governance	Principles based framework	Rule based framework

Overview

Scope

IFRS 17 applies to a range of different contracts:

- Insurance and reinsurance contracts issued by the entity;
- Reinsurance contracts held by the entity; and
- Investment contracts with discretionary participation features ('DPF'), if the entity also issues insurance contracts.

IFRS 17 defines **insurance contracts** as contracts under which significant insurance risk is transferred.

What is insurance risk '**significant**'?

Insurance risk is significant if, and only if, an insured event could cause the issuer to pay additional amounts that are significant in any single scenario, excluding scenarios that have no commercial substance.

Challenge:

Measurement of investment contracts will be different to Solvency II.

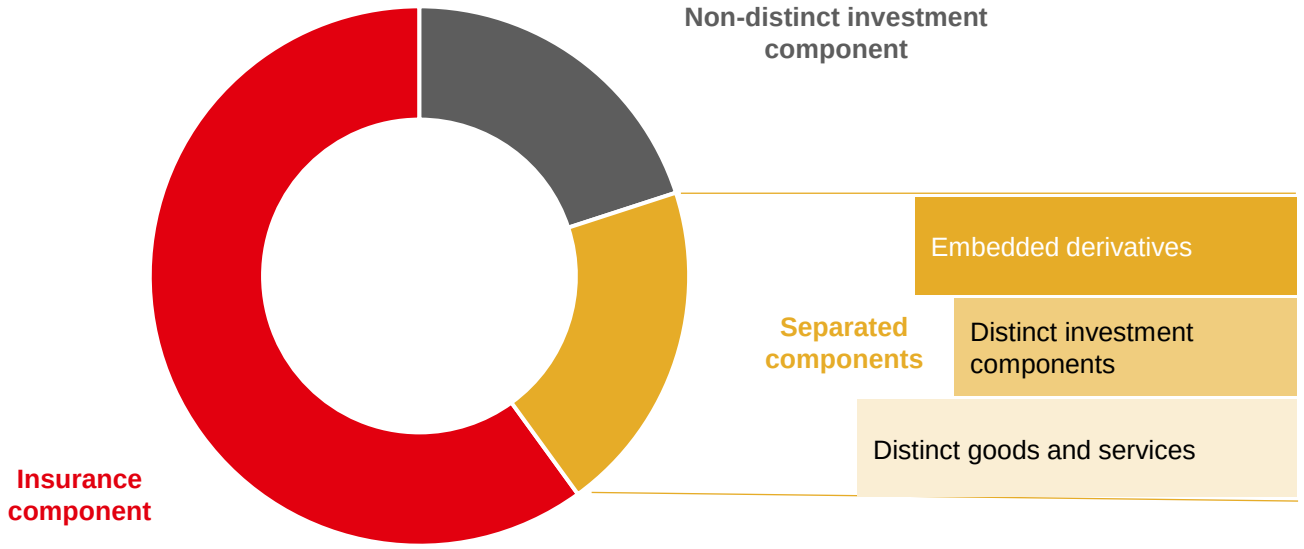
Solvency II

Applies to all contracts regulated as insurance. No distinction made between insurance and investment contracts.

Overview

Separating components

Insurance contracts create a bundle of components. The entity must evaluate which of the components need to be separated from the original contract under IFRS 17 (see pie chart).



Challenge:

Measurement of components separated in IFRS can be different from Solvency II.

Solvency II

No allowance for separation of components.

GROUPING OF CONTRACTS

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Grouping of contracts

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Level of aggregation: IFRS 17

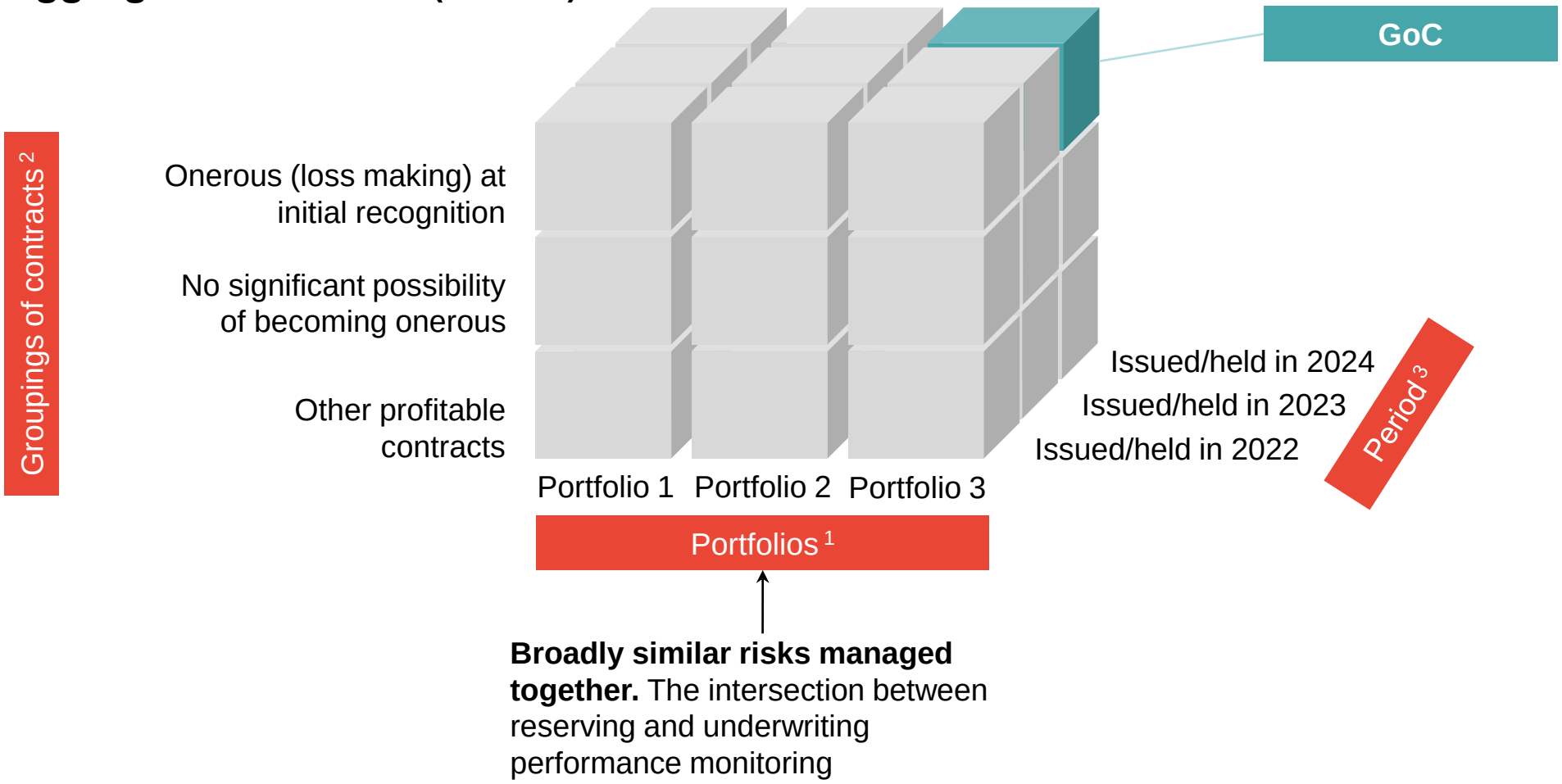
IFRS 17 establishes specific principles for grouping contracts together. This grouping is particularly relevant for the determination of the contractual service margin (CSM) and the limitation of offsetting effects for subsequent measurement.

In contrast to Solvency II contracts must be disaggregated into groups of contracts ‘GoC’.

subject to “similar risks” and are “managed together”…	divided into three subgroups according to profitability…	issued no more than one year apart

Grouping of contracts

Level of aggregation: IFRS 17 (cont'd)



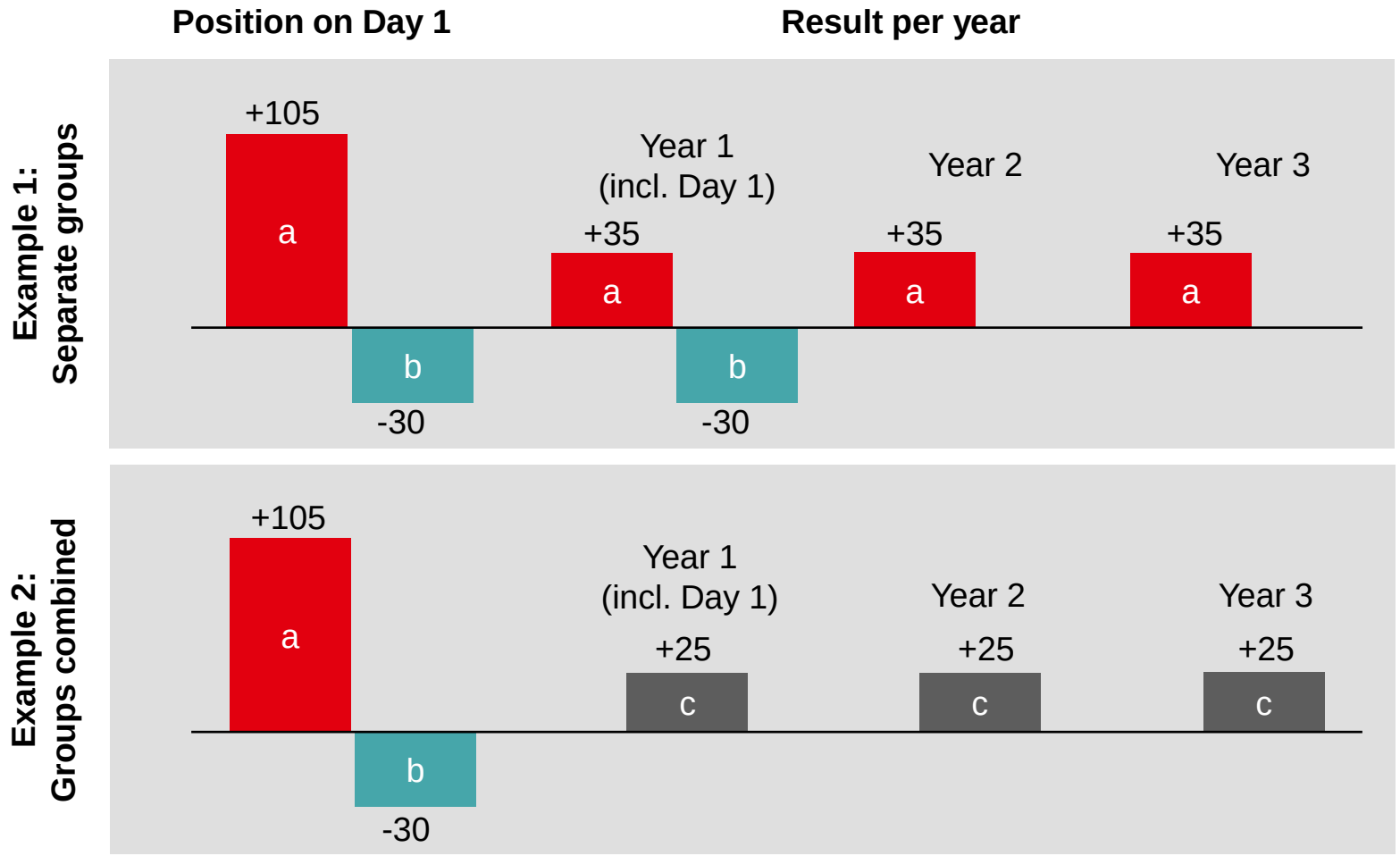
Broadly similar risks managed together. The intersection between reserving and underwriting performance monitoring

Grouping of contracts

Level of aggregation: IFRS 17 (cont'd)

Example: Two policies – a and b and combined effect c

This example assumes the CSM is amortized linearly. The effect of time value of money is ignored for the sake of simplicity.



Grouping of contracts

Segmentation: Solvency II

Solvency II lines of business ('LoB')

- Prescribed
- Minimum level at which the entity must segment contracts.

Homogeneous risk groups ('HRG')

- Further split of Solvency II lines of business for calculation and projection purposes.
- Sets of obligations which are managed together, and which have similar characteristics.

The principle of substance over form: The segmentation should reflect the nature of the risks underlying the contract (substance), rather than the legal form of the contract (form).

Guideline 21: '*Where an insurance or reinsurance contract covers risks across different lines of business, unbundling of the obligations is not required where only one of the risks covered by the contract is material. In this case, the obligations relating to the contract should be segmented according to the major risk driver.*'

Grouping of contracts

Grouping of contracts: IFRS 17 vs Solvency II

Solvency II

Example: 2 portfolios [1]

- Portfolio 1: Closed book
- Portfolio 2: Open book

Grouping by profitability

IFRS 17 grouping (assuming Solvency II portfolio grouping is appropriate)

Year 1	Year 2	Year 3
Onerous	Onerous	Onerous
In-between	In-between	In-between
Profitable	Profitable	Profitable
In-between	In-between	In-between
Profitable	Profitable	Profitable
	In-between	In-between
	Profitable	Profitable
		In-between
		Profitable

New business added during the year
Requirement: new group

New business added during the year
Requirement: new group

Number of groups is growing over the years (if new contracts are written)

IFRS 17 portfolio requirements

A portfolio of insurance contracts are contracts:

- Subject to similar risks (e.g. contracts within each product line); and
- Managed together as a single pool

[1] It is assumed that the portfolio 2 does not include onerous contracts.

Remark: As per amendments from June 2020, the entity is required to present insurance contract assets and liabilities on the balance sheet in portfolios instead of in groups.

INITIAL RECOGNITION

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Initial recognition

When to recognize a group of insurance contracts

Under IFRS 17 insurance contracts are to be initially recognized:

Earliest of

- Coverage period starts
- First payment from policyholder is due or actually received
- Group of contracts is onerous

Challenge:

Potential for different recognition due to the 'first payment' (IFRS) versus 'party to' (Solvency II) condition; and the level of grouping and onerous contract test in IFRS.

Solvency II

- Earlier of:
  - Date the entity becomes a party of the contract
  - Coverage period starts
- *Note: This usually includes 1/1 renewals for a valuation as of 31 December ('WBNYI' business)*

LIABILITY MEASUREMENT

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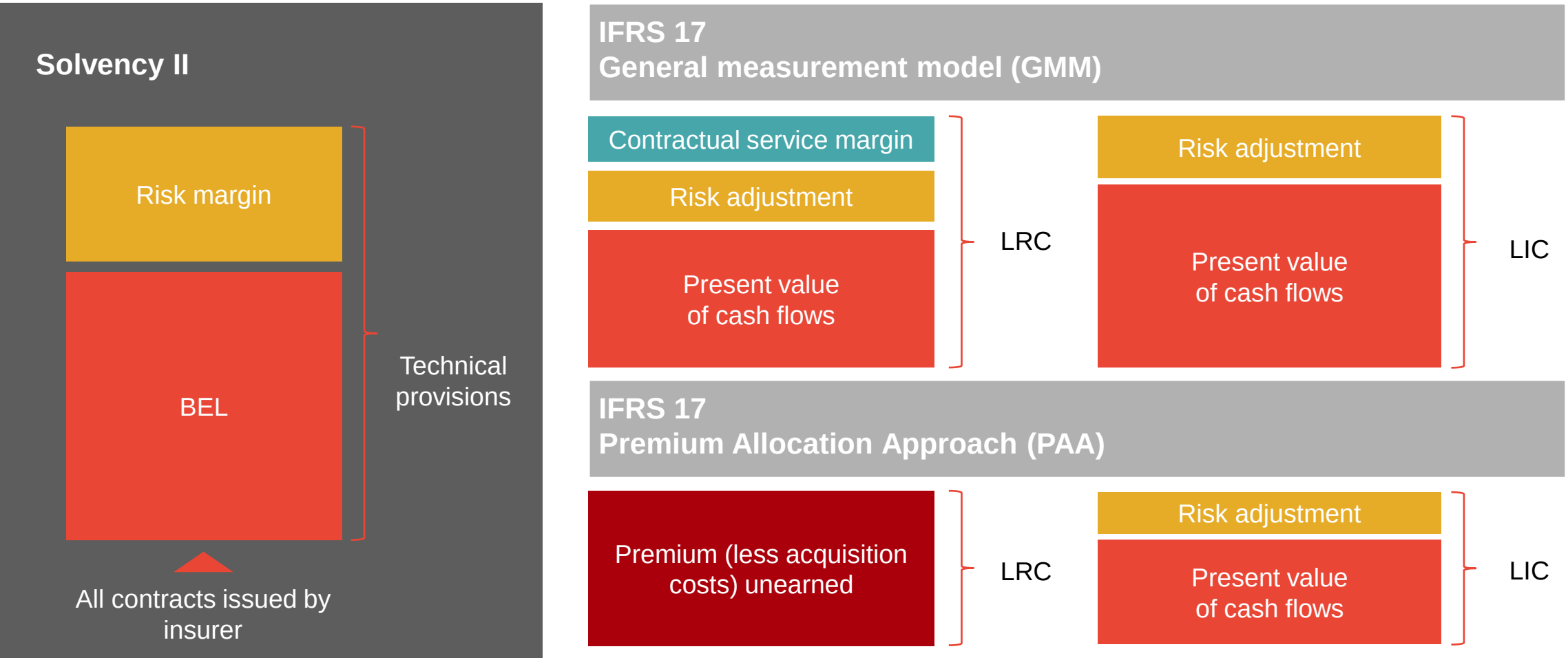
Liability measurement

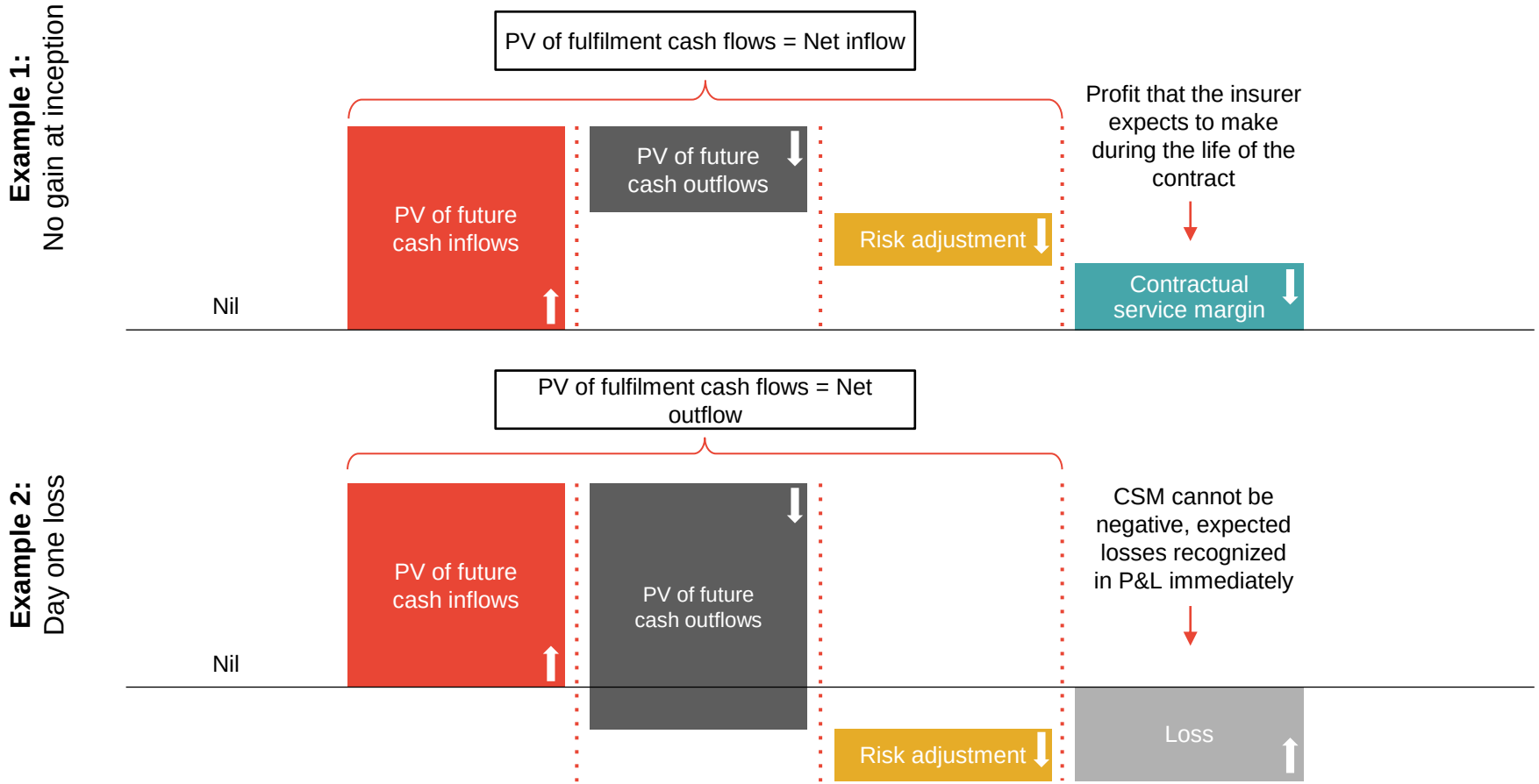
Overview



The relative size of the diagram is purely for illustration purposes only and could differ significantly by product and company.

Liability measurement

General measurement model – Initial recognition



Note: CSM is assumed for a group of insurance contracts.

Liability measurement

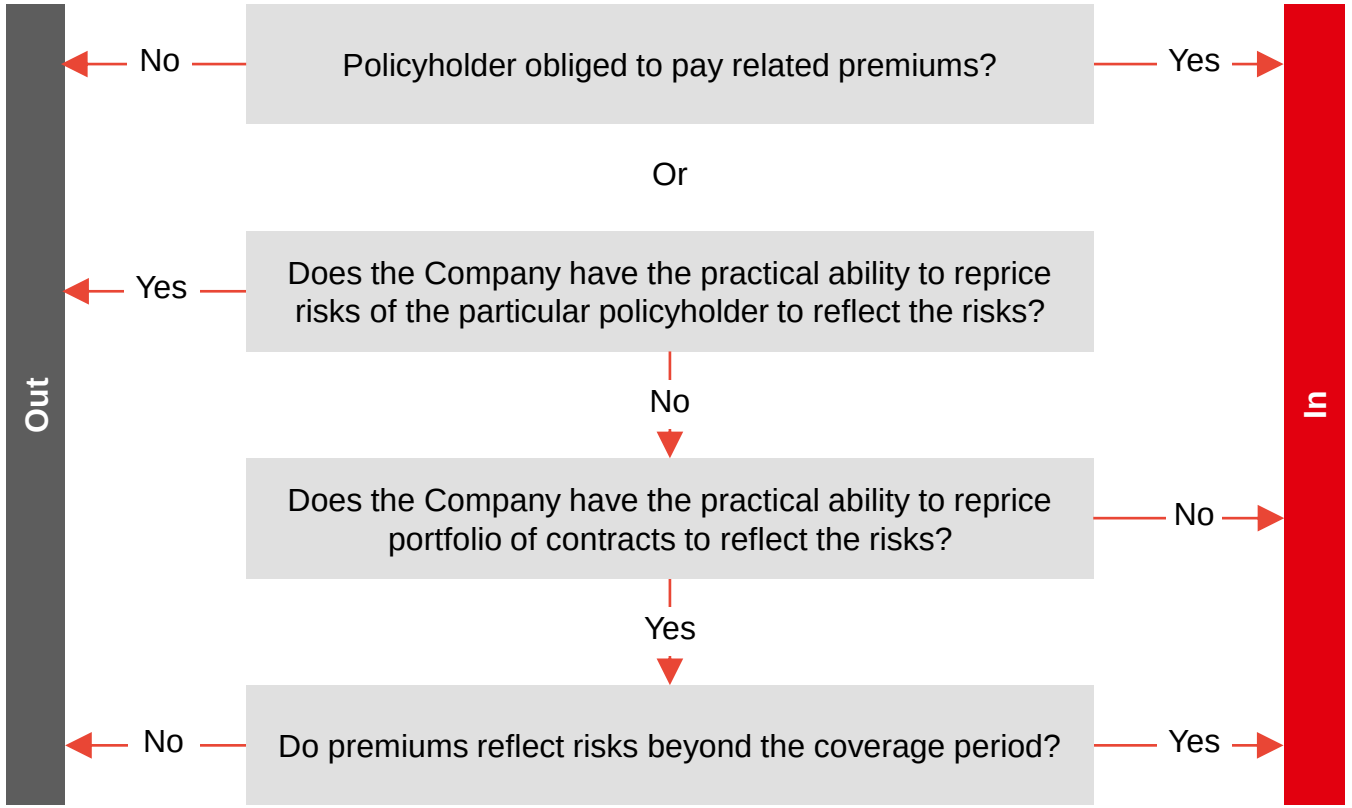
Contract boundary: IFRS 17

IFRS 17.34

Contract boundary is where the entity has right or practical ability to reassess risk of particular policyholder and can re-price; or where both of the following are satisfied:

- Entity has right or practical ability to reassess risk of portfolio of insurance contracts and can re-price; and
- Pricing of premiums up to reassessment of risks does not take into account future risks.

The diagram below illustrates whether a contract is included within the boundary of a contract:



Liability measurement

Contract boundary: Solvency II

Where the insurer has a unilateral right to:

- cancel the contract;
- reject the premium; or
- an unlimited ability to amend the premium or the benefits (or otherwise re-underwrite the risk)

at some point in the future, any premiums received beyond that point (and any resulting cash out-flows) do not belong to the existing contract. **If these rights relate only to a part of the contract, only this part should be excluded from the existing contract**.

Challenge:

Contract boundary definition could be different between Solvency II and IFRS depending on the terms of the contracts. For example, there is a requirement in Solvency II to disaggregate contracts into components, where the contract boundary differs between components. There is no such equivalent requirement in IFRS.

Liability measurement

Cash flows: IFRS 17 vs Solvency II

IFRS 17

- **Probability weighted mean** of range of possible outcomes
- **Current**
- **Unbiased**
- Reflect the entity perspective for **non-market variables**
- Consistent with observable **market prices**
- Include **options and guarantees** cash flows

Solvency II

- **Probability-weighted average** of future cashflows
- Based upon **up-to-date** and **credible information** and **realistic assumptions**
- Include all the **cash in- and out-flows** on-going basis
- Calculated **gross** with a separate explicit calculation for **reinsurance recoverables**
- Include **financial guarantees and contractual options**
- Include cash flows for **unincepted business** under the legal obligation basis

Liability measurement

Examples of cash flows: IFRS 17 vs Solvency II

IFRS 17

- Premiums and related payments
- Claims and benefits, including paid in kind
- Insurance acquisition cash flows
- Claim handling costs
- Policy administration and maintenance costs
- Transaction-based taxes and levies
- Recoveries such as salvage and subrogation
- Fixed and variable overheads[1]
- Other costs[1]

Solvency II

- Future premiums due for incepted and unincepted business ('WBNYI')
- Benefits (including claims payments) payable to policyholders or beneficiaries
- Expenses incurred in servicing (re)insurance obligations
- Recoverables for salvage and subrogation
- Taxation directly relating to settling of insurance obligations

[1] Only if directly related to the fulfilment of the contract

Liability measurement

Expense assumptions: IFRS 17 vs Solvency II

IFRS 17 requirements

The requirements relating to expenses – the following cash flows are included:

- Claim handling costs
- Policy administration and maintenance costs[1]
- An allocation of fixed and variable overheads[2] directly attributable to fulfilling insurance contracts
- Any other costs specifically chargeable to the policyholder

The following cash flows shall not be included:

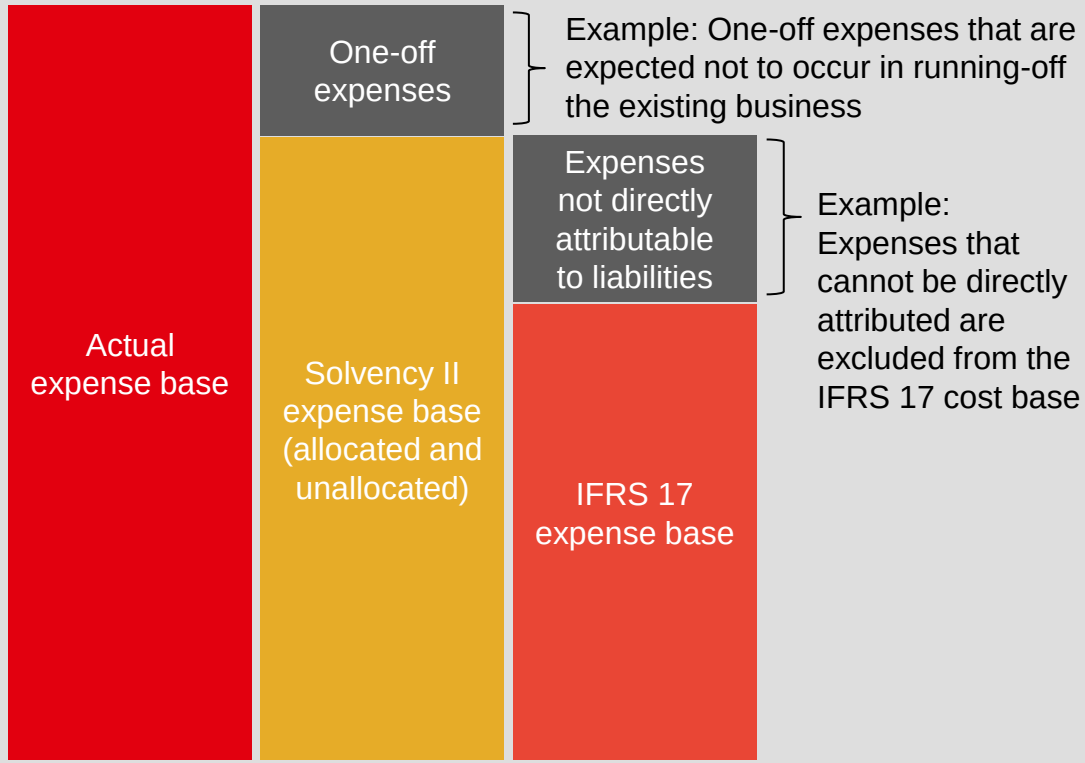
- Cash flows relating to costs that cannot be directly attributed to the portfolio of insurance contracts[3]
- Cash flows that arise from abnormal amounts of wasted labor or other resources that are used to fulfil the contract

[1] Such as costs of premium billing and handling policy changes

[2] Such as the costs of accounting, human resources, information technology and support, and maintenance and utilities

[3] Such as some product development and training costs

Impact



Note: The relative size of the diagram is purely for illustration purposes and could differ significantly by product line and company

Liability measurement

Acquisition costs: IFRS 17 vs Solvency II

IFRS 17

- Allocated to existing and future groups of insurance contracts using a systematic and rational method.
- Included in insurance contract fulfilment cash flows resulting in implicit deferral.
- Only directly attributable to a portfolio of insurance contracts to which the group belongs.

- **DAC will no longer be presented as an asset under IFRS 17**.

Solvency II

- Expensed as incurred in servicing insurance contracts.
- No equivalent concept of deferring such costs over the life of the contract in Solvency II.
- Acquisition costs related to future premiums shall be taken into account within best estimates.

Liability measurement

Discounting: IFRS 17 vs Solvency II

IFRS 17

Discount rates should:

- Reflect the time value of money and financial risks
- Be consistent with observable current market prices
- Exclude the effect of factors that influence observable market prices, but do not affect future cash flows of the insurance contract

IFRS 17 requires the use of the discount rate which applied at inception in certain circumstances (e.g. CSM interest accretion, adjustment to the CSM for contracts without DPF).

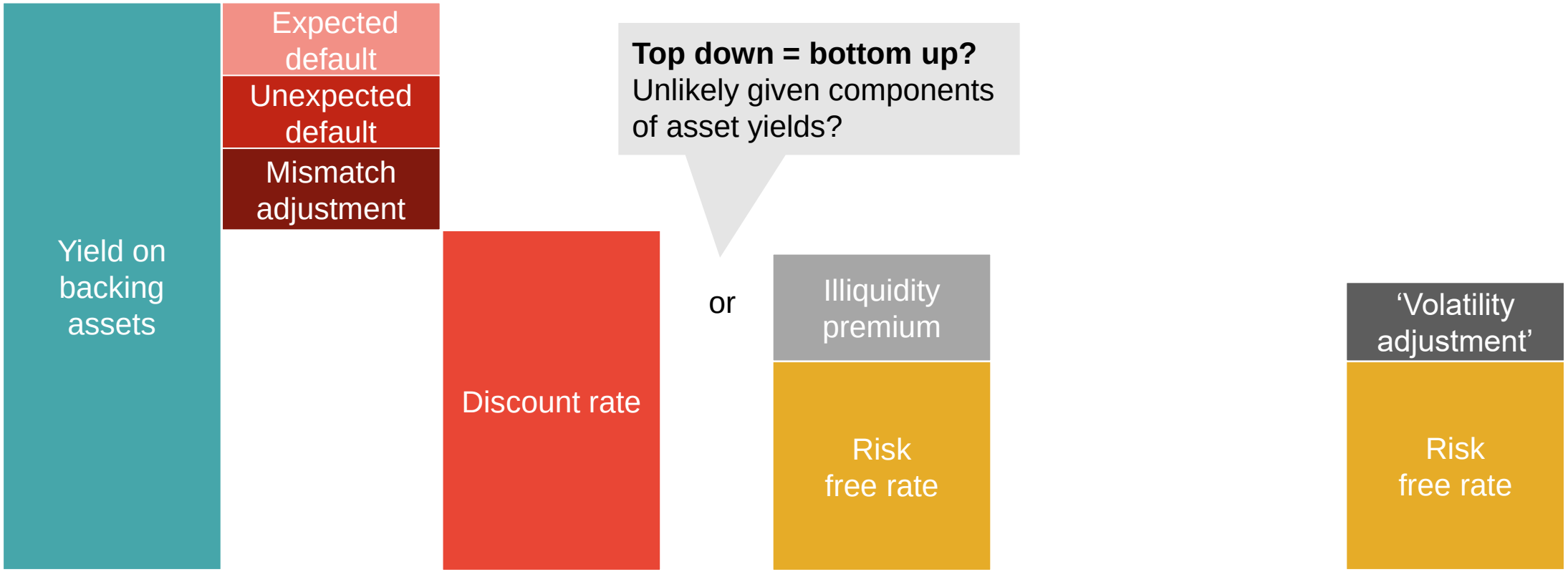
Solvency II

Expected future cashflows to be discounted using a “risk-free” yield curve published by EIOPA on a monthly basis to ensure consistent calculation of technical provisions.

Solvency II always requires the use of current rates.

Liability measurement

Discounting: IFRS 17 vs Solvency II (cont'd)



The relative size of the diagram is purely for illustration purposes only.

Liability measurement

Allowance for risk: IFRS 17 vs Solvency II

IFRS 17

Risk adjustment

- Compensation for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risks (Company's own view).
- **Method** – No prescribed method.
- **Scope of risks** - Narrower than Solvency II
- **Calibration of risks** - Not prescribed (principle-based)
- **Diversification** - Not prescribed (principle-based)
- **Impact of reinsurance** - Separate risk allowance for insurance and reinsurance held
- **Unit of account** - Not prescribed but should be ultimately allocated to group of contracts

Solvency II

Risk margin

- Represents 'the amount an insurance company would require to take on the obligations of a given insurance company'.
- **Method** – Prescribed 6% cost of capital method.
- **Scope of risks** - Prescribed set of risks
- **Calibration of risks** - Standard Formula or internal model
- **Diversification** – Entity level
- **Impact of reinsurance** - Single net of reinsurance risk margin
- **Unit of account** - Line of business

Liability measurement

Risk adjustment IFRS 17 – possible approaches

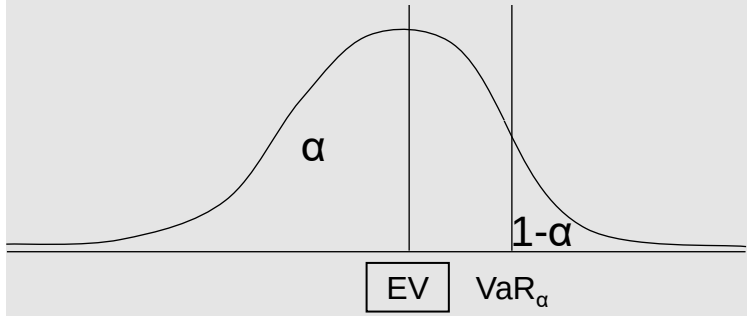
Cost of capital approach

Possibility to leverage SII Risk Margin process noting differences including:

- Cost of Capital under IFRS allows for group diversification; SII is based on legal entities.
- Risk Adjustment is measured separately for gross and ceded business, and must be allocated to a group of contracts.
- For BBA, the Risk Adjustment must be measured as at contract inception, in addition to the financial statement date.
- Only risk related to the fulfilment of the insurance contracts are considered (e.g. premium and reserve risk included, fx risk excluded if hedgeable).

Quantile approaches

- Risk Adjustment is defined as the VaR or tVaR that corresponds to a certain quantile, e.g. α = 70%.



- Due to diversification effects, the sum of VaR across Divisions (or any other segmentation) does not correspond to the VaR at the same quantile.

Other approaches

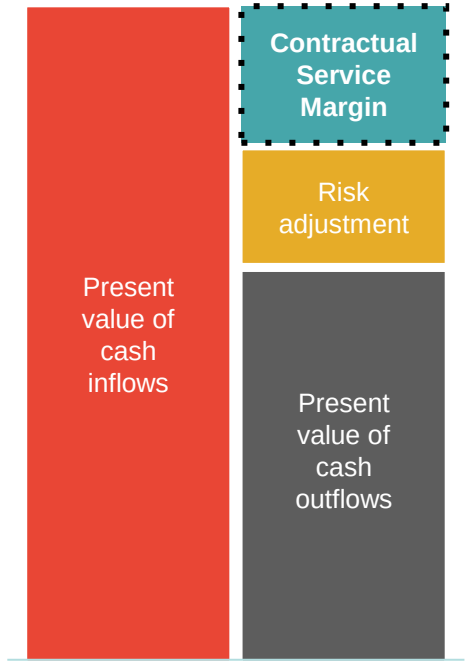
- The Standard does not prescribe a method. The entity can choose any method that has certain characteristics, e.g. contracts with higher variability should be allocated a higher Risk Adjustment.
- The method used must be disclosed.
- The quantile that corresponds to the Risk Adjustment must be disclosed.

Liability measurement

Profit recognition: IFRS 17 vs Solvency II

IFRS 17 Contractual service margin (CSM):

- Represents the unearned profit that the entity will recognize as it provides services under the insurance contract.
- Determined at the level of groups of contracts within a portfolio.
- Ensures that profit is released in each period to reflect the services provided in that period.
- Deferral of day 1 profit, but day 1 losses (except for reinsurance held)' recognized.
- Assessed using day 1 (‘locked-in’) discount rates.

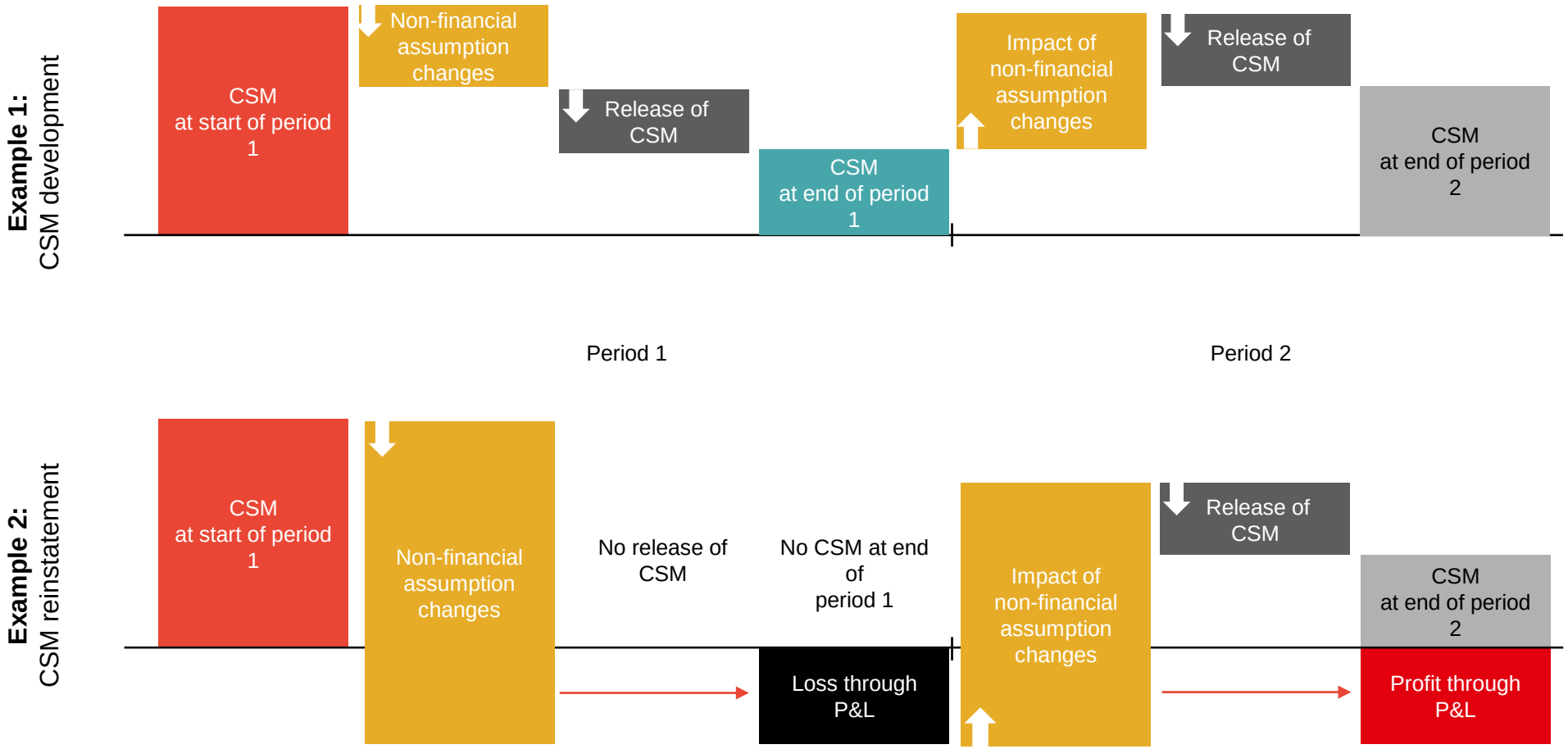


CSM calculation
at initial recognition

No comparable concept of profit recognition under Solvency II. Day-one gains or losses are recognized for all contracts, including reinsurance.

Liability measurement

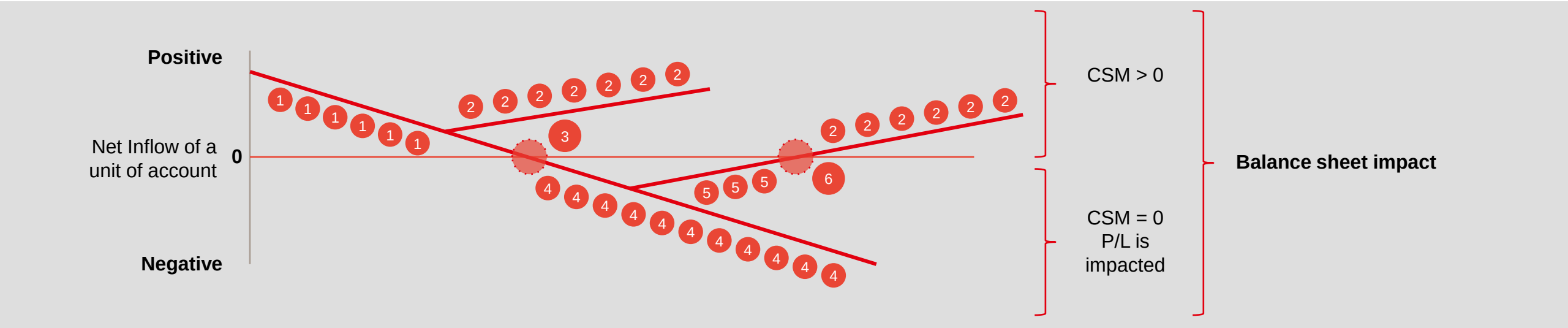
CSM examples (release / reinstatement)



Note: CSM is assumed for a group of insurance contracts. Over the periods no new contracts are written.

Liability measurement

The journey of a CSM



Explanations

1. This is normally the expected development of the CSM value over time for a unit of account (grouped insurance contracts)
2. If unexpectedly claims do not occur for the contracts in the unit of account, than the value goes up
3. In case original computation were incorrect or unexpected high claims occur, the value of the contract can turn negative; as the CSM can not turn negative, the loss needs to be taken and booked on a ‘loss account’

4. If high claims continue to exist unexpectedly, than the CSM remained null and further losses need to be taken in the P/L; again the loss taken should be booked on a loss account
5. If the unexpected claims start to become lower, the CSM stays at zero but credits can be made to the P/L coming from the loss account
6. Finally, if the CSM value turns positive again, the loss account is put to zero and the last amounts are added to P/L profit.

Note: CSM is assumed for a group of insurance contracts. Over the periods no new contracts are written.

REINSURANCE HELD

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Reinsurance held

Initial recognition: IFRS 17 vs Solvency II

IFRS 17

Recognize the group of reinsurance contracts at the earlier of:

- the beginning of the coverage period of the group of reinsurance contracts held; and
- the date the entity recognizes an onerous group of underlying insurance contracts.

Proportional coverage: the later of the beginning of the coverage period of the group, or the initial recognition of any underlying contract.

Solvency II

- Reinsurance recoverables shall be calculated consistently with the boundaries of the insurance or reinsurance contracts to which those amounts relate.
- Future reinsurance cover not yet bought that will cover existing underlying contracts (e.g. LOD cover incepting in the following year) might be recognized as a **management action** (assuming sufficient justification as per EIOPA's guidelines).

Remark: As per amendments from June 2020, it is required that the entity recognizes losses on insurance contracts on initial recognition to recognize at the same time expected recoveries of those losses from reinsurance contracts held that the company entered into before or at the same time as the loss-making insurance contracts were recognized.

Reinsurance held

Measurement requirements: IFRS 17 vs Solvency II

IFRS 17

Ceded business measured and presented separately, i.e. no offset by the underlying gross contracts.

Including the effects of **collateral (e.g. funds withheld)** and losses from disputes.

Potential mismatches between direct and RI contracts:

- Measurement models
- Granularity in unit of account
- Alignment to underlying unit of account
- CSM

Solvency II

- **Recoverables from reinsurance contracts** shown **separately** on the asset side of the balance sheet.
- **Deposits** shown **separately** in the balance sheet.
- **Consistent basis** as for calculation of the gross best estimates, separately for claims provisions and premium provisions.
- **Risk margins are not required** in respect of reinsurance (risk margins are calculated at a net level).

PRESENTATION AND DISCLOSURE

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Presentation and Disclosure

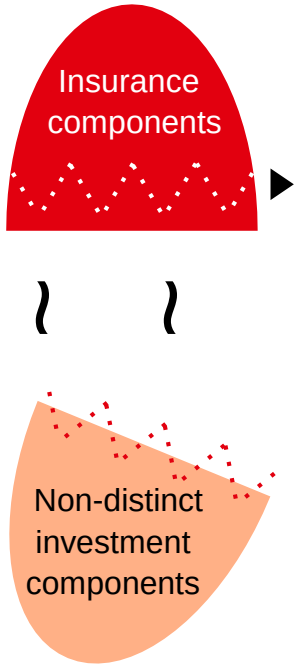
Statement of comprehensive income: IFRS 17

No Solvency II equivalent…

Contractual service margin

Risk adjustment

Current unbiased probability weighted estimates of present value of future cash flows



Revenue and expense are recognised as services delivered and incurred respectively
Investment components are excluded from revenue and service expense

	20XX	20XX
Insurance revenue[1]	X	X
Insurance service expenses	(X)	(X)
Insurance service result	**X**	**X**
Investment income	X	X
Insurance finance income or expenses	(X)	(X)
Investment result	**X**	**X**
Profit or loss	**X**	**X**
Other Comprehensive Income[2]	(X)	(X)
Total comprehensive income	**X**	**X**

If OCI option is chosen, difference between current and locked-in market variables are presented in OCI

[1] Premiums due or premiums written, is prohibited.
[2] Entities have an accounting policy choice to recognize the impact of changes in discount rates in profit or loss or in other comprehensive income ('OCI') to reduce some volatility in profit or loss.

MARKET UPDATES ON IFRS 17

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Market updates on IFRS 17

Key headlines

- Analysis done by **E&Y** (link in Appendix), published in March 2023.

Discount rate curve

- **Ageas**: *Top-down approach aligned with discount rates in S2*
- **AXA**: *RFR + ILP (framework similar to SII)*
- **Generali**: *Bottom-up approach aligned with S2*
- **Munich Re**: *Bottom-up approach in accordance with Solvency II parameters*
- **NN Group**: *Methodology similar to SII*

Risk adjustment

- **Allianz**: *Assumptions broadly consistent with SII risk margin*
- **Aviva**: *Leverages Solvency II view of risk but allows for diversification and considers lifetime (vs. one year) view*
- **Munich Re**: *Cost-of-capital approach based on Solvency II risk capital*
- **NN Group**: *Consistent with SII, with a lower cost of capital (4% vs. 6% under S2)*

Non-attributable expenses

- **Ageas**: *Full cost view, allocating non-attributable costs both in life & P&C*
- **Aviva**: *More than 90% of Solvency II maintenance expenses are directly attributable*
- **AXA**: *On L&H, ca 5% of non-attributable expenses indicated by AXA*
- **CNP Assurances**: *Most of the administrative expenses now included in the insurance service result*

WORKED EXAMPLES

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Worked examples

Example 1 – Initial recognition

Fact pattern

- Entity X is bound to an insurance contract as of 1st December 20X0
- The coverage period of the insurance contract starts on 1st January 20X1
- This example assumes that the group of contracts comprises only this contract
- Coverage period is 1 year
- Premiums of **CU500** are due at the end of each quarter (**total contractual premiums CU2 000**)
- X expects claims and expenses (directly attributable) of **CU1 600** to be incurred evenly at the end of each quarter
- Claims are settled as they are incurred
- The IFRS 17 risk adjustment on initial recognition is **CU240** and is released evenly over the coverage period
- The Solvency II risk margin on initial recognition is **CU300**
- Effect of **discounting** is considered **negligible**

Worked examples

Example 1 – Initial recognition

Analysis

IFRS 17 initial recognition

- On 1st of December 20X0 and 31st December 20X0 (reporting date), the entity X assesses if any facts and circumstances indicate that the insurance contract is onerous.
- As the contract is not onerous, X recognizes the group first time on 1st January 20X1 (earlier of '*coverage period start*' and '*first payment*').

Solvency II initial recognition

- On 1st of December 20X0, the entity X is bound to the insurance contract *('party to the contract').*
- The contract is included in a technical provision exercise with a 31 December valuation date as written but not yet incepted business ('*WBNYI*').

Worked examples

Example 1 – Valuation as of 31.12.20X0

IFRS 17

X has not initially recognized the contracts as of **31st December 20X0**; hence, insurance contract liability (LRC) is nil.

Solvency II

The Solvency II technical provisions as of **31st December 20X0** can be summarized as follows:

- X calculates the technical provisions as of YE20X0 as a sum of BEL (Premium provision) + Risk margin
- Premium provision is made up of:
  - Present value of future premiums of CU-2 000
  - Present value of claim and expense outflows of CU1 600
  - BEL = CU-400
- Technical provisions as of YE2020 equal CU-100 (BEL CU-400 + Risk margin CU300).

Worked examples

Example 1 – Valuation as of 01.01.20X1

IFRS 17

X measures the insurance contract liability on initial recognition as of **1st January 20X1** as follows:

- Estimates of the present value of future cash inflows CU-2 000
- Estimates of the present value of future cash outflows CU1 600
- Risk adjustment CU240
- Fulfilment cash flows CU-160
- Contractual service margin CU160
- **Insurance contract liability on initial recognition is nil**.

Solvency II

No changes to the valuation of technical provisions as of **1st January 20X1**.

Worked examples

Example 1 – Valuation as of 31.03.20X1

IFRS 17

X measures the insurance contract liability on subsequent measurement as of **31st March 20X1** as follows:

- Estimates of the present value of future cash inflows CU-1 500
- Estimates of the present value of future cash outflows CU1 200
- Risk adjustment CU180
- Fulfilment cash flows CU-120
- Contractual service margin CU120

Solvency II

The Solvency II technical provisions as of **31st March 20X1** are as follows:

- Premium provision is a sum of:
  - Present value of future premiums of CU-1 500
  - Present value of claim and expense outflows of CU1 200
  - BEL = CU-300
- Technical provisions equal CU-75 (BEL CU-300 + Risk margin as of 20X1 Q1 CU225).
- Remark: *Claims provision is **nil** as claims are settled as they are incurred*.

Over the coverage period, all events happen as expected and X does not change any assumptions related to future periods.

Worked examples

Example 1 – Valuation as of 31.03.20X1

IFRS 17

Statement of profit or loss as of **31st March 20X1**:

Insurance revenue of CU500:

- CU400 (expected claims)
- CU60 (risk adjustment recognized)
- CU40 (CSM release)

Insurance service expense of CU400:

- CU400 (incurred claims and expenses)

Insurance service result of CU100

Solvency II

No Solvency equivalent.

Over the coverage period, all events happen as expected and X does not change any assumptions related to future periods.

Worked examples

Example 2 – Boundary of reinsurance contracts held

Fact pattern

Underlying insurance business

- Insurance entity E issues a group of insurance contracts with a coverage period of one year
- Premiums of **CU1 000** are received on initial recognition
- E expects to pay out total claims of **CU600**, incurred evenly each quarter
- Claims are settled as they are incurred
- This same group of contracts is expected to be written year on year (premiums due as of 31 Dec)
- Effect of **discounting** is considered **negligible**

Worked examples

Example 2 – Boundary of reinsurance contracts held

Fact pattern (cont'd)

Reinsurance held

- At the same time of initial recognition of group of insurance contracts E enters into a **50% quota share** reinsurance contract (**RAD cover**) with a coverage period of 2 years
- Claims are recovered as they are settled (50% of each claim arising from the underlying contracts)
- Single reinsurance premium paid on initial recognition of 50% of the underlying business
- The reinsurer has:
  - neither the practical ability to reassess the risks transferred to the reinsurer
  - nor can set a price or level of benefits for the contract to fully reflect the reassessed risk

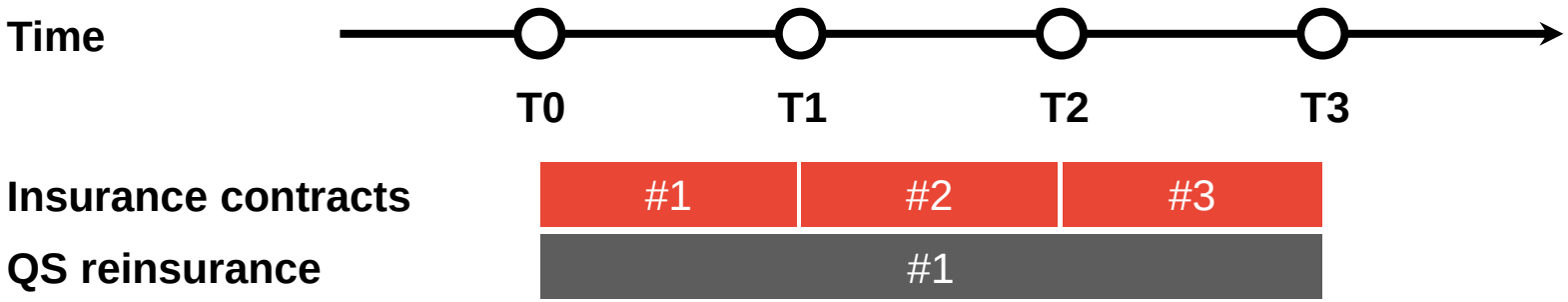
Worked examples

Example 2 – Boundary of reinsurance contracts held

Analysis

IFRS 17 contract boundary

- The boundary of a reinsurance contract held includes cash flows from underlying contracts that are expected to be issued in the future, i.e.:



- This is due to the reinsurer not 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 recognized.

Worked examples

Example 2 – Boundary of reinsurance contracts held

Analysis

Solvency II contract boundary

- The boundary of a reinsurance contract held includes cash flows consistent with the underlying insurance contracts included in the same valuation.
- Only cash flows in respect of reinsurance recoveries that relate to existing or legally obliged underlying contracts shall be included with no consideration of the future underlying business.
- Remark: Any future premiums payable on existing or legally obliged reinsurance contracts (e.g. minimum and deposit premiums) shall be included at the level to which they are contractually obliged based on existing or legally obliged underlying contracts, with no consideration to the future business.

Worked examples

Example 2 – Boundary of reinsurance contracts held

The table below shows the reinsurance premium and claim cash flows expected to be included on initial recognition of the reinsurance contract under both frameworks:

Business legally bound

		20X0					20X1					20X2				
		Jan	Mar	June	Sept	Dec	Jan	Mar	June	Sept	Dec	Jan	Mar	June	Sept	Dec
Solvency II	Premiums	-500														
	Claims		75	75	75	75										
IFRS 17	Premiums	-500					-500					-500				
	Claims		75	75	75	75		75	75	75	75		75	75	75	75

Worked examples

Example 3 – Boundary of reinsurance contracts held with repricing mechanisms

Fact pattern

- Entity Y enters into a **30% quota share** reinsurance contract (**RAD cover**) to cover for new business to be issued over the next 2 years.
- The reinsurance contract includes a **unilateral right** to both the cedant and the reinsurer to terminate the contract, subject to a minimum **notice period of six months**.
- Y expects to issue **three one-year insurance contracts** all in the first 12 months of the two-year period covered by the reinsurance contract. These contracts are issued on **1 January**, **30 June** and **31 December** in year one respectively with their coverage period starting at the same date.
- In this example the reinsurance contract held, as a single contract, is identified as a group of insurance contracts.

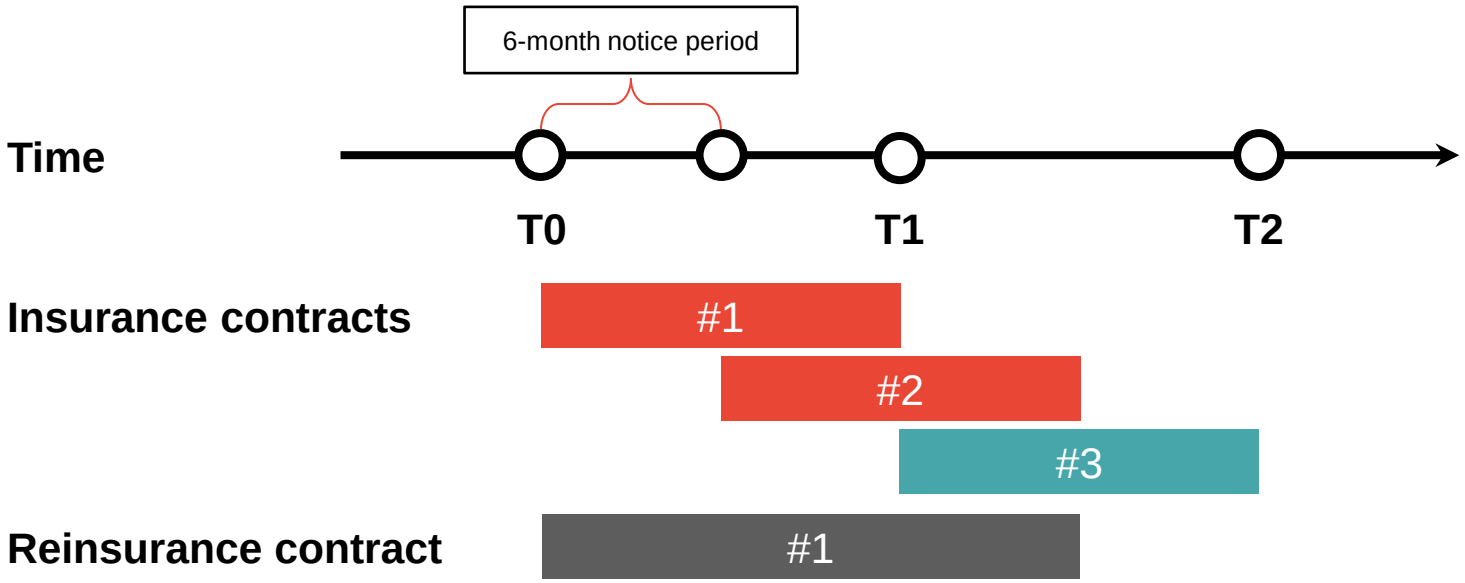
Worked examples

Example 3 – Boundary of reinsurance contracts held with repricing mechanisms

Analysis

IFRS 17 contract boundary

- The boundary of a reinsurance contract held includes cash flows from underlying contracts #1 and #2 that are inside the six-month notice period. The present value of the future cash flows of the reinsurance contract held excludes cash flows related to the third contract #3, issued on 31 December.



Worked examples

Example 3 – Boundary of reinsurance contracts held with repricing mechanisms

Analysis

Solvency II contract boundary

- Similar to Example 2; only cash flows in respect of reinsurance recoveries that relate to existing or legally obliged underlying contracts on the initial recognition shall be included with no consideration of the future underlying business.

Worked examples

Example 4 – Investment component in reinsurance contracts issued

Fact pattern

- Assume an annual quota share contract with
  - A) profit commissions of 50% of the profit under the contract (difference between the premiums and losses).
  - B) sliding scale commissions MaxCom 30% / LR 45%; MinCom 20% / LR 55%
- Reinsurance premiums of CU100

Worked examples

Example 4 – Investment component in reinsurance contracts issued

Analysis

IFRS 17 defines an investment component as:

- '*The amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur*'

TRG, September 2018, para 31:

- '*reinsurer is required to repay to the cedant in all circumstances*'

IFRS 17 requires the entity to treat:

- cash flows **contingent on the claims** or benefits in the underlying contracts, including ceding commissions, as **part of the claims** that are expected to be reimbursed under the reinsurance contract held, unless those cash flows need to be accounted for as **investment components**.
- ceding commissions that are **not contingent on claims** of the underlying contracts as a **reduction of the premiums** to be paid to the reinsurer.

Worked examples

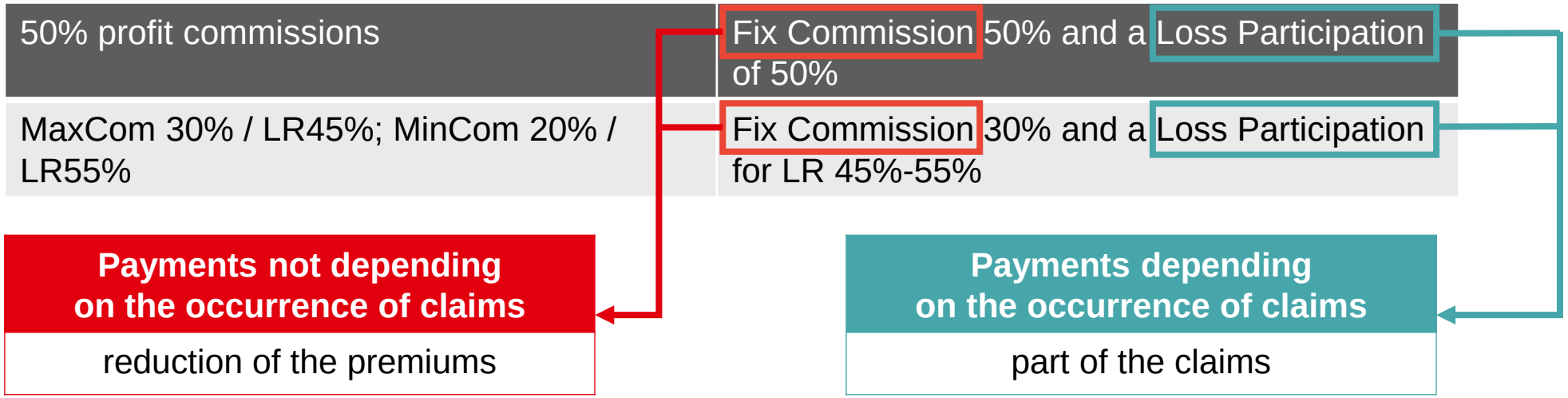
Example 4 – Investment component in reinsurance contracts issued

Analysis (cont'd)

Examples of cash flows contingent on claims:

- Profit commissions
- Sliding scale commissions

However, sliding scale or a profit commissions could also be interpreted as a loss participation of the insurer:



Worked examples

Example 4 – Investment component in reinsurance contracts issued

Analysis (cont'd)

Result dependent conditions: Quota Share with 100 premium and 50% profit commissions

Premiums	Losses	PC	Total out flow	Result
100	95	2,5	97,5	**2,5**
100	75	12,5	87,5	**12,5**
100	55	22,5	77,5	**22,5**
100	50	25	75	**25**
100	45	27,5	72,5	**27,5**
100	25	37,5	62,5	**37,5**
100	0	50	50	**50**

Premiums	Losses	Fix commission	Loss participation	Result
100	95	50	47,5	**2,5**
100	75	50	37,5	**12,5**
100	55	50	27,5	**22,5**
100	50	50	25	**25**
100	45	50	22,5	**27,5**
100	25	50	12,5	**37,5**
100	0	50	0	**50**

Worked examples

Example 4 – Investment component in reinsurance contracts issued

Analysis (cont'd)

Result dependent conditions: Quota Share with 100 premium and sliding scale commission MaxCom 30% / LR45%; MinCom 20% / LR 55%

Premiums	Losses	SSC	Total out flow	Result
100	95	20	115	**-15**
100	75	20	95	**5**
100	65	20	85	**15**
100	55	20	75	**25**
100	50	25	75	**25**
100	45	30	75	**25**
100	35	30	65	**35**
100	25	30	55	**45**
100	0	30	30	**70**

Premiums	Losses	Fix commission	Loss participation	Result
100	95	30	10	**-15**
100	75	30	10	**5**
100	65	30	10	**15**
100	55	30	10	**25**
100	50	30	5	**25**
100	45	30	0	**25**
100	35	30	0	**35**
100	25	30	0	**45**
100	0	30	0	**70**

Worked examples

Example 4 – Investment component in reinsurance contracts issued

IFRS 17

Statement of profit or loss for QS with a premium of 100, LR 50% and 50% profit commissions:

- Insurance revenue of CU50
- Insurance service expense of CU25
- **Insurance service result of CU25**

IFRS 17

Statement of profit or loss for QS with a premium of 100, LR 50% and a sliding scale commission of MaxCom 30% / LR45%; MinCom 20% / LR 55%:

- Insurance revenue of CU70
- Insurance service expense of CU45
- **Insurance service result of CU25**

APPENDIX

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Back-up

Interaction between IFRS 17 and Solvency II - EFRAG

EFRAG concludes that in implementing IFRS 17, there are possible synergies with Solvency II, but the extent of such synergies varies between insurers. In addition, ***no synergies are expected*** *for building blocks that are specific to IFRS 17 such as* ***the contractual service margin*** *which is not an element of the measurement approach for insurance liabilities under Solvency II.* ***Synergy potential is available*** *in areas that have a high degree of commonality under the two frameworks, i.e. the building blocks for the* ***measurement of the insurance liability needed to establish the cash flow projections****, and actuarial systems to measure insurance liabilities. The potential depends, to an extent, on the differences in the starting position of insurers and the investments already made in the implementation of Solvency II. It also depends on the amount of effort to adapt existing actuarial systems, that were developed for the Solvency II environment, to the IFRS 17 reporting requirements.*

Links

Market updates on impact of IFRS 17 and IFRS 9 (EY, March 2023)

https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/insurance/insurance-pdfs/ey-market-updates-on-impact-of-ifrs-17-and-ifrs-9-march-2023.pdf?download