



IFRS 17 Insurance Contracts



Introduction

IFRS 17 was released in May 2017 and it is quite a complex standard. The standard replaces IFRS 4 (Insurance Contracts) – an interim standard – which does not particularly prescribe a measurement policy for insurance contracts.

If you take a look at various insurance contracts around the world, you would find that they are accounted for using different measurement frameworks. What the new standard does is that it tries to achieve a consistent insurance accounting framework, which inevitably means that there are a lot of changes for everyone who issue insurance contracts. This newsletter highlights the key provisions of IFRS 17, including its scope, recognition requirements, measurement models, disclosure requirements as well as an overview of the impact of the new standard.

Definition of insurance contract

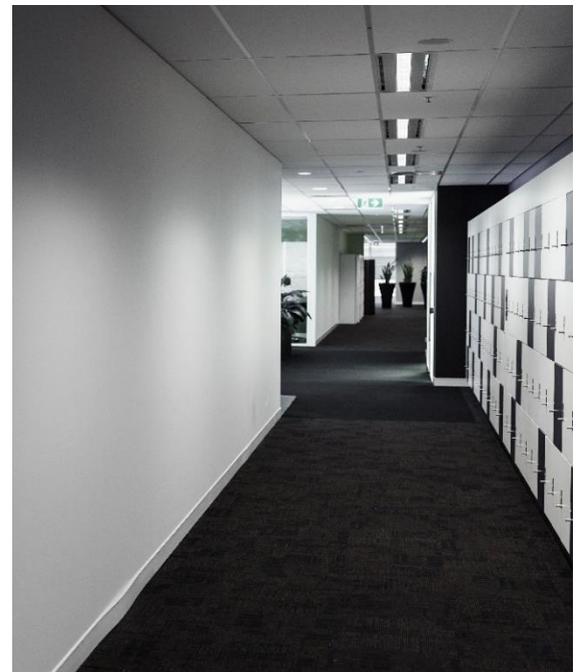
The definition is the same as under IFRS 4 which is a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

Scope

IFRS 17 applies to:

- Insurance contracts, including *reinsurance contracts*, an entity issues - there are no significant changes in the scope compared to IFRS 4.
- Investment contracts *with discretionary participation features* an entity issues, provided the entity also issues insurance contracts.
- Fixed fee service contract- An entity can make an irrevocable choice to apply IFRS 15 instead of IFRS 17, if these contracts meet pre-defined conditions. The choice can be made on a contract by contract basis.
- Financial guarantees- With these, IFRS 17 also provides a choice. If the insurance company previously asserted that these are insurance contracts under the previous insurance standard, then that continues under IFRS 17 but if they have previously been classified under the financial instrument standard, then the Company can carry on with that classification.

It is worthy to note that IFRS 17 will not only affect traditional insurance companies, but also health insurance providers, service providers that issue bundle products, such as ateleccom services provider that attached insurance products to its services.. Policyholder accounting is out of scope of IFRS 17 (except for reinsurance contracts held)



Initial recognition

On initial recognition, an entity shall measure a group of insurance contracts at the total of:

- a) **the fulfilment cash flows, which comprise:**
 - i. estimates of future cash flows ;
 - ii. an adjustment to reflect the time value of money and the financial risks related to the future cash flows, to the extent that the financial risks are not included in the estimates of the future cash flows ; and
 - iii. a risk adjustment for non-financial risk
- b) **the contractual service margin**

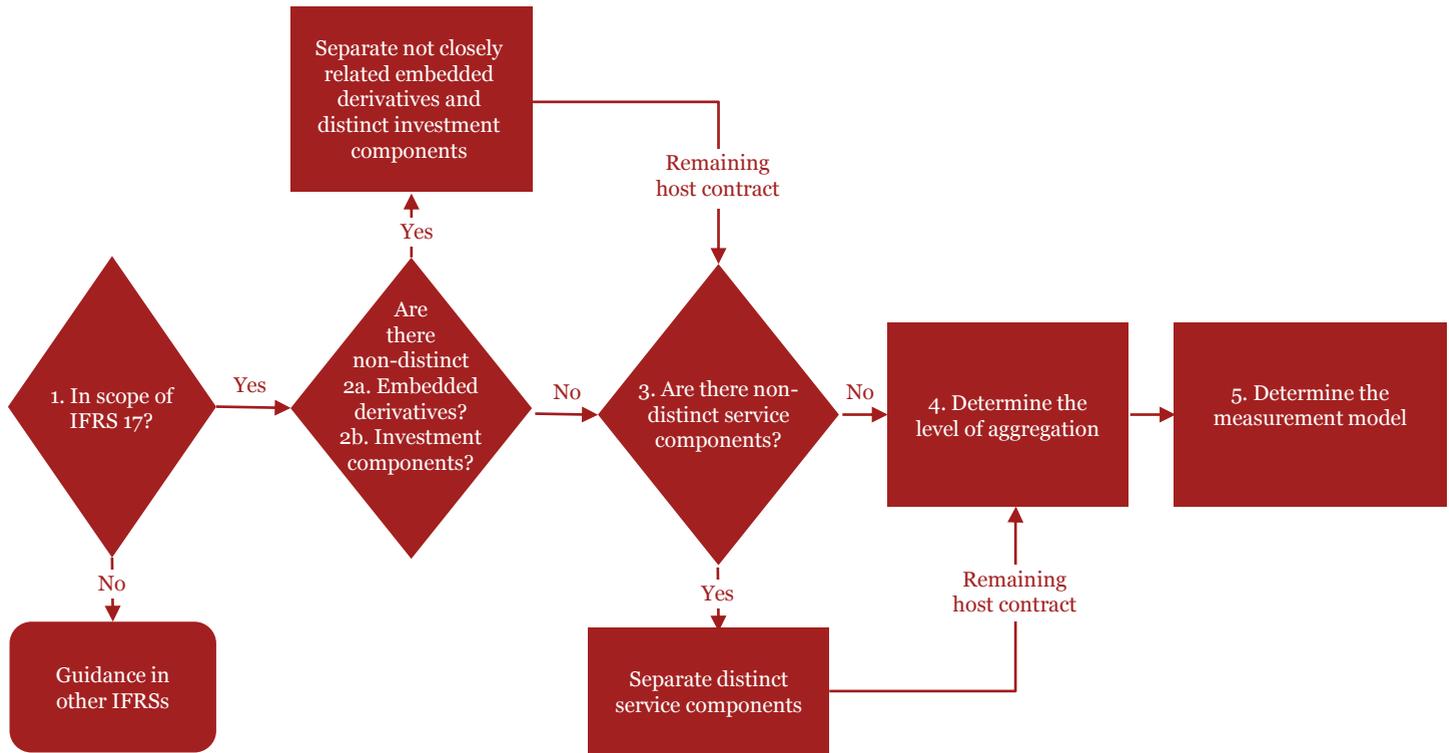
The diagram on the next page provides an overview of activities to be performed when a contract is initially recognised.



About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 158 countries with more than 236,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more by visiting us at www.pwc.com/ng

© 2017 PricewaterhouseCoopers Limited. All rights reserved. In this document, PwC refers to PricewaterhouseCoopers Limited (a Nigerian limited liability company), which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.



IFRS 17 measurement models

There are three measurement approaches under IFRS 17 for different types of insurance contracts – the general model, premium allocation approach (PAA) and the variable fee approach (VFA). The diagram below reflects an overview of the different approaches.

	 General model	 Premium allocation approach (PAA)	 Variable fee approach
Why is it needed?	Default model for all insurance contracts	To simplify for short term contracts with little variability	To deal with participating business where payments to policyholders are linked to underlying items like assets
Types of contract	<ul style="list-style-type: none"> Long-term and whole life insurance, protection business Certain annuities US style universal life <ul style="list-style-type: none"> Reinsurance contracts written Certain general insurance contracts 	<ul style="list-style-type: none"> General insurance Short-term life and certain group contracts 	<ul style="list-style-type: none"> Unit-linked contracts, US variable annuities and equity index-linked contracts Continental European 90/10 contract With profits contracts
Mandatory?	Mandatory	Optional	Mandatory

Reinsurance contracts

A *reinsurance contract* is an insurance contract issued by one entity (the reinsurer) to compensate another entity for claims arising from one or more insurance contracts issued by that other entity. The diagram below describes contractual relations between a reinsurer, insurer and policyholder, and the contracts that each party holds as a result of those contractual relationships.



Reinsurance contracts issued are similar to direct insurance contracts issued, and they should be accounted for by the reinsurer using either the general model or the premium allocation approach.

Reinsurance contracts held should be recognised and measured using the general model or the premium allocation approach. However, there are a number of specific requirements in IFRS 17 for reinsurance contracts *held*, with respect to initial recognition date, onerous direct insurance contracts and cash flows measurement.

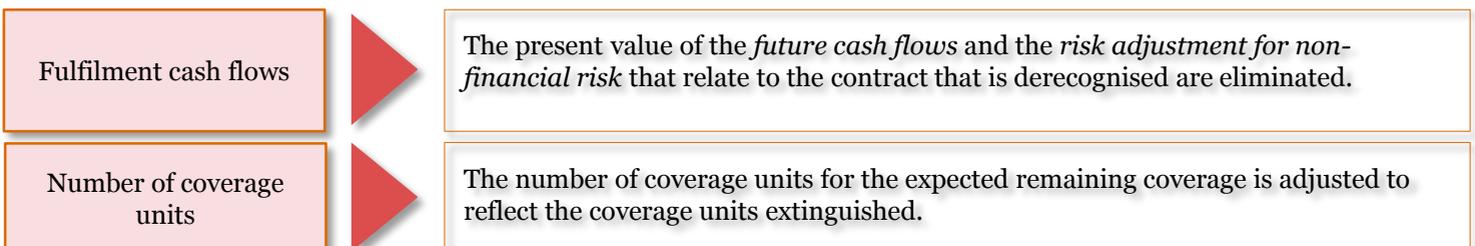
Modification and derecognition

IFRS 17 includes specific rules relating to when insurance contracts are derecognised and how they should be accounted for if modified after being issued.

The terms of an insurance contract can be modified after inception, for example by agreement between the parties to amend the contract or by a change in regulation. Companies should derecognise the original contract and recognise the modified contract as a new contract if certain conditions are met.

- **Modification** – amendment to an insurance contract.
- Exercise of rights under original terms is NOT a modification.
- Can result in derecognition, otherwise treated as a change in estimate.

- **Derecognition** – extinguishment, transfer or modification.
- Extinguishment - obligation expires, is discharged or cancelled.



Adjustment of the CSM – different requirements for:



Transition and disclosures

An entity shall disclose qualitative and quantitative information about the:

- amounts recognized in its financial statements that arise from insurance contracts;
- significant judgements, and changes in those judgements, made when applying IFRS 17; and
- nature and extent of the risks that arise from insurance contracts.

On transition to IFRS 17, an entity applies IFRS 17 retrospectively to groups of insurance contracts, unless it is impracticable. In this case, the entity is permitted to choose between a modified retrospective approach (in which case, the entity applies transition requirements at the transition date rather than on initial recognition of the insurance contracts) and the fair value approach (here, the insurance contracts are measured and recognised at fair value in accordance with IFRS 13).

Where is the impact?

The adoption of IFRS 17 will have wide-ranging and significant impacts on underlying processes, systems, internal controls, valuation models, investor education and other fundamental aspects of the insurance business as shown in the diagram below.

It is also interesting that the measurement model uses data that may not necessarily have been used in the past, so operational and system implications are huge around IFRS 17.



Business

- Investor education, including the need for revised non-GAAP (Generally Accepted Accounting Principles) measures
- Timing and volatility of profit emergence, and its impact on distributable earnings
- Reconsider product design
- Overhaul planning, budgeting and forecasting functions
- Business combination and acquisition activities



Operational

- Increased risk of incorrect, inaccurate or incomplete financial information
- New financial reporting, impacts on Integrated Reporting. IT and actuarial controls and processes
- Education and people strategy



Systems

- Record, process and report a greater volume of data with an increased level of complexity
- Enhance actuarial models
- Redesign or replace source, feeder and reporting systems
- Additional load on infrastructure (processing and storage capacity)
- Implications for 3rd party arrangements

On a final note.

Get organised!!!

IFRS 17 is effective for periods beginning on or after 1 January 2021. This may seem a long time away, however, the reason the effective date was deferred is because IFRS 17 is a very complex standard that would take time to implement. Therefore, insurance companies need to start looking at it now. It is important that insurers understand the impact and plan the road to transition to the new standard in good time.

The transitional process includes:

- 1) Project setup, governance and resources
- 2) Assess the impact
- 3) Project planning
- 4) Gather and validate data
- 5) Implement systems and processes – design, build, test, deploy
- 6) Dry run and comparatives

 ***You need to start now!!***



For further information, please contact;

Omobolanle Adekoya
Partner, PwC
omobolanle.adekoya@pwc.com
+234 807 500 0540

Uloma Ojinmah
Associate Director, PwC
uloma.ojinmah@pwc.com
+234 803 650 8393

Ololade Abanum
Manager, PwC
ololade.abanum@pwc.com
+234 803 823 3511