Financial Services Knowledge Series on IFRS 17

Reinsurance contract – Insurance for insurer

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Introduction

In the previous volume, we learned about the Variable Fee Approach (VFA) under IFRS 17. Contracts such as 'with-profits' and 'unit-linked', which have direct participating features, are eligible for a modified version of the accounting rules. In this final volume of our knowledge series on IFRS 17, we will explore reinsurance contracts, scope, level of aggregation and their measurement for IFRS 17 contracts.

What is reinsurance?

A reinsurance transaction is a contract agreed upon by two or more parties: the reinsured or ceding firm and the reinsurer(s). The reinsurer(s) agree to absorb a share of the reinsured's risk according to the agreement's terms and conditions.

A reinsurer assumes a portion of the risk that an insurer has covered under the arrangement. Therefore, reinsurers work with professional corporate counterparties such as primary insurers, reinsurance brokers, or multinational organisations with their own insurance firms known as captive insurers.

Reinsurance assists insurers in risk management by absorbing part of their losses. Reinsurance stabilises insurance firm outcomes and allows for further expansion and innovation.

Reinsurers contribute considerably to the actual economy due to the massive quantities of money that they invest in financial markets.

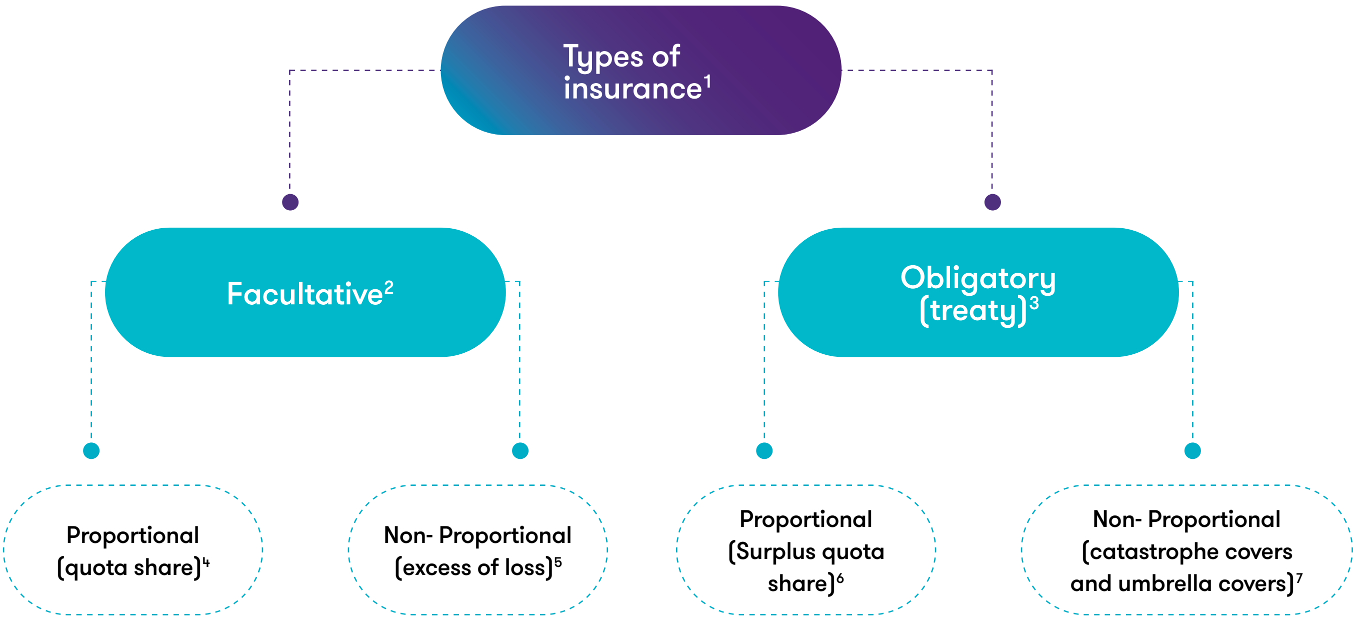
Insurers safeguard their balance sheets, decrease profit volatility, and make better use of capital by shifting risks.

Reducing the balance sheet volatility can improve an insurance company's risk-return profile. All other things being equal, the company becomes more and more appealing to equity and debt market investors as volatility declines. This is a very significant advantage, especially for non-life insurers.

Significant catastrophes or unforeseen liability claims might result in variations in large earnings for non-life insurers, which diminishes their value to investors.

Types of reinsurance

Types of reinsurance



Types of reinsurance (1)

Reinsurance is of two different fundamental types. The primitive type of reinsurance, facultative, transfers risks on a case-by-case basis. The alternative is the obligatory (treaty) reinsurance, when an insurer and reinsurer are required to cede and take on a predetermined portion of a portfolio of risks.

Facultative reinsurance (2)

By 'risk', insurance underwriters don't just mean certain dangers; they also mean the actual covered items. For instance, a structure or a bridge might present a risk that calls for insurance. Such risks are vulnerable to several dangers and provide a complicated situation that would necessitate individualised care on the part of the reinsurer.
Because it works on a case-by-case basis, facultative reinsurance is the best option for these risks.

In a facultative contract, the reinsurer preserves the choice—or 'faculty'—to accept or reject all or any policy given to it, unlike obligatory reinsurance, which, as its name suggests, entails forced risk sharing. The decision about which risks to reinsure is also left up to the primary insurer. Nowadays, facultative reinsurance is mostly used by the primary insurer as an addition to obligatory reinsurance, protecting against new risks not currently covered by the obligatory reinsurance treaty.

Obligatory reinsurance (3)

An obligatory reinsurance contract is most likely appropriate when the primary insurer wants to reinsure all its insurance policies under specific risk categories. Reinsurance for both life and non-life products uses this type of coverage.
A main insurer consents to transfer to the reinsurer a share of the risk associated with all its health insurance policies or its motor insurance policies. Since both parties must cede or take any risks covered by the agreement they reach, obligatory reinsurance gets its name. The treaty obligates the reinsurer to take on its fair share of the risks, and it cannot refuse to offer insurance coverage for a specific risk or policy that is covered by the agreement.

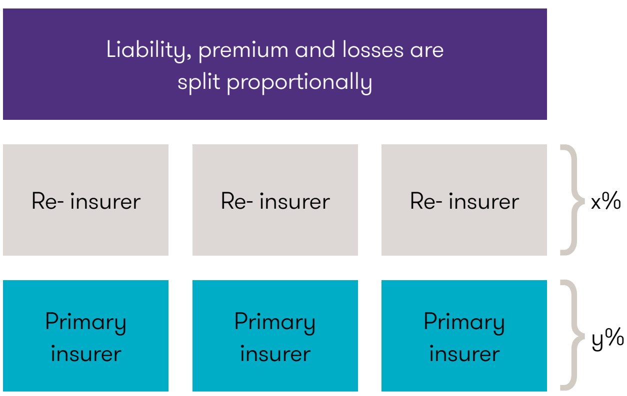
Reinsurance that is obligatory and facultative can both be proportional or non-proportional. For each policy an insurer writes, proportional reinsurance entails one or more reinsurers assuming a pre-determined percentage share of the premiums and liabilities. On the other hand, non-proportional reinsurance compensates losses that exceed a certain amount.

Proportional reinsurance

- According to a ratio specified in their contract, the primary insurer and the reinsurer split the premiums and losses under proportional reinsurance. The reinsurer's portion of the premiums directly relates to its responsibility to cover losses. By paying a reinsurance commission, the reinsurer also reimburses the primary insurer for a portion of its acquisition and management expenses. Often, this is shown as a percentage of the initial premium. The commission paid to the primary insurer also serves as the reinsurance's price; it is adjusted in accordance with the portfolio's quality and is determined separately from the primary insurer's initial premium.

Quota share (4)

- The quota share is the most basic type of proportional reinsurance. The direct insurer writes all the policies within the specific branch or branches specified in the treaty, and the reinsurer undertakes a predetermined, fixed quota or percentage of those policies. Each policy's premiums are split between a defined portion that the primary insurer keeps and the rest that it cedes. Losses are distributed according to the same ratio.
- This ratio may vary from risk to risk in other proportional reinsurance contracts, but it is set in quota share contracts. This means that the quota share is perfect for homogeneous portfolios with identical risks, such as home and auto insurance. Quota share agreements place a cap on the size of the insurance that can be ceded.
- Quota share reinsurance treaties are also particularly well suited for newcomers to a particular line of business or young, rapidly expanding insurers. For primary insurers looking for capital relief due to solvency concerns or protection against random changes across an entire portfolio, quota share reinsurance makes sense. Changes brought on by unforeseen legislative developments or economic circumstances, such as inflation, may also be a justification to enter a quota share.



An example

- The reinsurer's quota share in this illustration is 30%. This ratio is reflected throughout, with premiums and losses being split equally.

The primary insurer retains	70%
The reinsurer accepts	30%
Sum insured	20m
Primary insurer retains	14m
Reinsurer accepts	6m
Premium is 1% of the sum	2m
Primary insurer retains	1.4m
Reinsurer accepts	0.6m
Losses	5m
Primary insurer retains	3.5m
Reinsurer accepts	1.5m

Non-proportional reinsurance

Non-proportional reinsurance became an option and a supplement to conventional proportional kinds of cover in the 1970s. The financial stability of insurance companies was increasing, allowing them to hold onto the more frequent small risks for their own benefit. As a result, reinsurance options were explored that would offer protection against the largest and cumulative losses, those that would potentially endanger the solvency of primary insurers. To meet these needs, non-proportional kinds of insurance were developed, which refer to insurance where the split between premiums and losses is not defined or predetermined.

In the case of non-proportional reinsurance, the primary insurer is responsible for covering all losses up to a specific threshold. The deductible, net retention, excess point, or priority are other names for this amount. Losses in excess of this deductible are taken on by the reinsurer up to the pre-determined cover limit. For non-proportional covers, the loss amount is of utmost relevance, as opposed to proportional insurance, where the sum insured is the crucial number.

Excess of loss reinsurance: The most popular form (5)

Non-proportional reinsurance most frequently takes the form of excess of loss reinsurance.

It aids the insurance sector in managing various loss scenarios. A single building catching fire, as well as the accumulation of damages brought on by a single occurrence, such as a powerful windstorm, are examples of this.

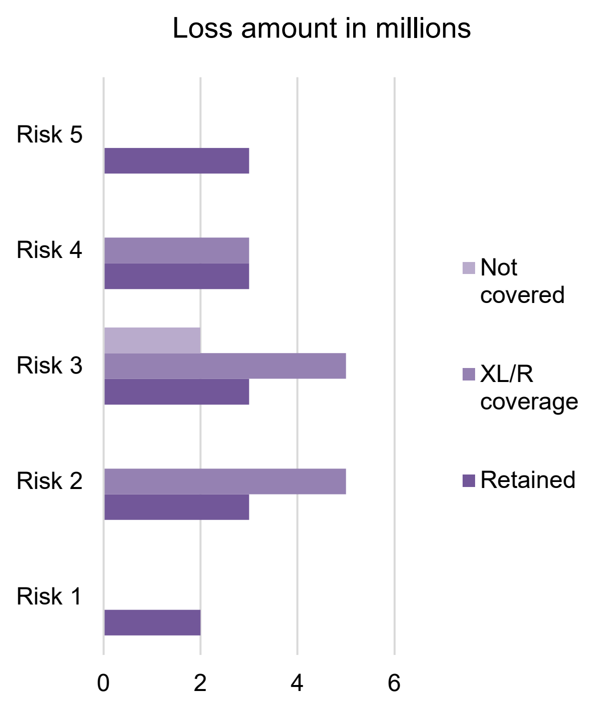
Catastrophe excess of loss or excess of loss per event and excess of loss per risk are two separate types of coverage that address these contrasting needs.

Excess of loss per risk is a conventional reinsurance product in which the reinsurer indemnifies the primary insurer for the loss amounts of each affected individual policy as stipulated in the terms and conditions of the treaty and in excess of the contractually fixed deductible. The reinsurance cover places a cap on the reinsurer's share in each claim, and there is typically an extra annual cap on the sum of all claims that the reinsurer is required to pay.

A particularly effective method of risk mitigation against significant single losses is the excess of loss per risk (e.g., a large bodily injury claim in motor third-party liability insurance or a large fire claim in property insurance).

However, such a contract does not offer adequate protection against frequency or cumulative losses, which happen when numerous policies are affected by the same loss event, such as a major natural disaster.

An Illustration



Once all proportional covers have been used, a direct insurer keeps 8 million. He purchases XL/R protection for 5 million more than 3 million (5 million xs 3 million) to safeguard his retention from significant loss.

Surplus reinsurance (6)

The most common type of proportionate reinsurance coverage is surplus reinsurance. With surplus reinsurance, the primary insurer retains the ownership of all risks up to a predetermined amount, while the reinsurer only participates in a portion of the risks. On the other hand, in quota share reinsurance, the retention is specified as a percentage beginning with the very first currency of premium. Surplus reinsurance requires the reinsurer to absorb any surplus or sum in excess of the original insurer's retention.

The maximum liability that a reinsurer is willing to assume serves as the basis for a surplus agreement's limit. This limit is typically expressed as a multiple of the line of retention held by the primary insurer. For instance, a three-line excess indicates that the reinsurer will assume coverage up to three times the retention of the main insurer.

Much more precisely than a quota share, surplus agreements can be used to calibrate a primary insurer's reinsurance requirements. Depending on the kind, size, and general risk appetite of the organisation, retentions can be established at different amounts. However, this flexibility comes at the expense of more time-consuming and expensive treaty management.

Catastrophe cover (7-I)

A more rational course of action in these circumstances is catastrophe excess of loss. The primary distinction between the excess of loss per risk and excess of loss per policy is that the latter uses the aggregate loss brought on by a single occurrence within the insurance portfolio covered by the reinsurance treaty as the unit of loss rather than the individual loss per policy.

The excess loss per event, which is made up of the aggregate of potentially hundreds or thousands of very minor losses caused by the same source, thus indicates effective risk protection against major catastrophe losses.

These could be claims made under personal property insurance following a windstorm or under motor insurance following a hailstorm.

Umbrella cover (7-II)

An umbrella insurance policy provides supplementary liability insurance coverage that goes beyond the limits of the insured's home, auto, or watercraft insurance.

Individuals with a large number of assets—or particularly valuable assets—who are at high risk of being sued, may find the additional coverage provided by an umbrella insurance policy to be the most beneficial. Small businesses utilise umbrella insurance to protect themselves from financial losses caused by claims.

If umbrella insurance is obtained from the same insurer that supplied the initial vehicle, home, or watercraft insurance, the rate may be lower.

Scope, level of aggregation and recognition

Scope and level of aggregation

Reinsurance contracts held

In Para 61 of IFRS 17 Insurance Contracts incorporating amendments as proposed in Exposure Draft Amendments to IFRS 17 - (herein referred as the 'IFRS 17 Insurance Contract') as:

"An entity shall divide portfolios of reinsurance contracts held applying paragraphs 14–24, except that the references to onerous contracts in those paragraphs shall be replaced with a reference to contracts on which there is a net gain on initial recognition. For some reinsurance contracts held, applying paragraphs 14–24 will result in a group that comprises a single contract".

A reinsurance contract held must be recorded separately from the underlying insurance contracts to which it refers, according to IFRS 17. This is because a holding company reinsurance contracts typically do not have the authority to offset the sums they owe to the underlying policyholder with sums they anticipate receiving from the reinsurer.

Even while each individual underlying contract exposes the insurer to significant insurance risk, reinsurance contracts frequently cover a wide range of underlying contracts, thus the issuer (i.e., the reinsurer) may not be exposed to the chance of a significant loss. Applying IFRS 17, a reinsurance contract is still considered to have transferred significant insurance risk even if it does not expose the issuer to the possibility of a significant loss because it transfers the reinsurer substantially all of the insurance risk associated with the reinsured portion of the underlying insurance contracts.

Some agreements, which are technically financial reinsurance arrangements, transfer all material risks back to the policyholder. Such contracts would not be covered by IFRS 17 because they are typically for financial instruments or services.

Transition Recognition Group (TRG) insight on reinsurance contract held

Reinsurance agreements can cover underlying insurance agreements that are a part of many insurance contract categories.

In order to reflect the underlying insurance contracts covered, the TRG discussed in February 2018 whether a reinsurance contract held should be divided into components for measurement.

1. In certain situations, a single contract's legal structure might not accurately reflect the nature of its contractual responsibilities and rights;
2. It takes considerable judgement and careful analysis of all pertinent facts and circumstances to overcome the presumption that the legal form of a single contract accurately reflects the substance of its contractual rights and duties; and
3. It is not sufficient to conclude that accounting for a reinsurance contract held as a single contract does not accurately represent the terms of its contractual rights and responsibilities just because it provides coverage for underlying insurance contracts that are included in various groups.

Level of aggregation

Under IFRS 17, a reinsurance contract held cannot be deemed burdensome. As a result, for holding reinsurance contracts, the criteria for grouping a portfolio have changed. An insurer anticipates either incurring a net cost of obtaining the reinsurance for a group of contracts held, or occasionally experiencing a net gain from doing so. As a result, when applying the grouping requirements to reinsurance contracts held, a portfolio is split into the following groups:

1. Contracts on which there is a net gain at initial recognition, if any;
2. Contracts on which at initial recognition there is no significant possibility of a net gain arising later; and
3. Contracts that are still in the portfolio, if any.

For some reinsurance contracts held, applying the requirements in IFRS 17 will result in a group that comprises a single contract.

Measurement

Measurement

Estimates of future cashflows

- The premiums paid by an entity for a reinsurance contract are deducted from any sums reimbursed by the reinsurer for expenditures incurred (for example, ceding commissions). The amount recognised by an entity for reinsurance contracts held can be expressed as:

  1. The reinsurer's share of the expected risk-adjusted present value of the cash flows generated by the underlying insurance contracts; and

  2. A contractual service margin (CSM) that equalises the initial measurement of the reinsurance asset to the amount paid for the reinsurance contract.

- Consistent assumptions are used to compute estimates of the present value of future cash flows for a group of holding reinsurance contracts and estimates of the present value of future cash flows for the group(s) of underlying insurance contracts. This covers any reinsurance contract-related financial risk and time value of money adjustments. As a result, the cash flows used to calculate the value of the reinsurance contracts held reflect how dependent those cash flows are on the cash flows of the underlying contracts that the reinsurance contract held covers.

- In addition, a risk adjustment for the possibility that the reinsurer won't fulfil its commitments under the reinsurance contract held is included in the estimated present value of future cash flows. The contractual service margin is unaffected by variations in the cash flows that occur from the reinsurer's risk of non-performance. Instead, when these adjustments take place, profit or loss is what is affected.

Estimates of risk adjustment

- For reinsurance contracts held, the rules in IFRS 17 for risk adjustment for non-financial risk are adjusted. For reinsurance contracts owned, the risk adjustment for non-financial risk is the amount of risk transferred to the reinsurer by the holder of the group of reinsurance contracts. Because the contracts will never be in the same unit of account, IFRS 17 requires direct liabilities and delegated obligations to be accounted separately. As a result, the RA for direct business and associated ceded business must be calculated separately.

- This concept is expressed in IFRS 17 insurance contracts Section 64, which requires an explicit risk adjustment for ceded reinsurance contracts:

Measurement under reinsurance

Estimates of future cashflows

- The reinsurer's share of the expected risk - adjusted present value of the cash flows generated by the underlying insurance contracts
- CSM that makes the initial measurement of the reinsurance asset equal to the amount the entity pays for the reinsurance contract

Estimate of RA

- The risk adjustment for non-financial risk represents the amount of risk being transferred by the holder of the group of reinsurance contracts to the reinsurer.
- The reinsurance held can be conceptualised as the risk adjustment for the reinsurance held.

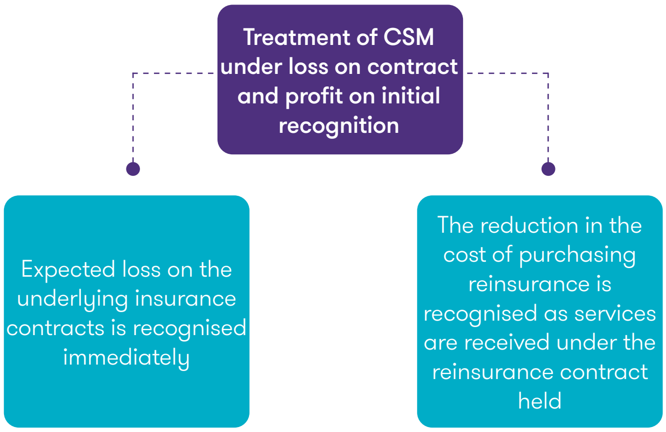
CSM

- The net cost at initial recognition is recognised right away in profit or loss if the reinsurance contract held covers events that have already happened.
- The expected cash inflows from the reinsurer are higher than the expected cash outflows to the reinsurer plus the risk adjustment for non-financial risk.

- An entity shall evaluate the risk adjustment for non-financial risk in a manner that accurately reflects the amount of risk being transferred from the holder of the group of reinsurance contracts to the issuer of those contracts, as opposed to implementing Paragraph 37. A special definition for calculating the risk adjustment for held reinsurance contracts is used in place of the general definition for insurance and reinsurance contracts found in Paragraph 37 of the standard. The magnitude of the non-financial risk adjustment represents the amount of risk transferred from the holder of a set of reinsurance contracts to the issuer of those contracts, in accordance with the definition of reinsurance held (Paragraph 64).
- So, the difference between the entity's risk position with (i.e., net position) and without (i.e., gross position) the reinsurance held can be conceptualised as the risk adjustment for the reinsurance held. So, based on the difference between these amounts, the required risk adjustment for the reinsurance held might be calculated.
- Because the risk adjustment for held reinsurance is determined by the amount of risk that has been transferred to the reinsurer, it usually results in the creation of an asset. Hence, the risk adjustment will have the impact of increasing the asset value when a reinsurance contract is held and lowering the liability value when a reinsurance contract is held and reported as a liability.

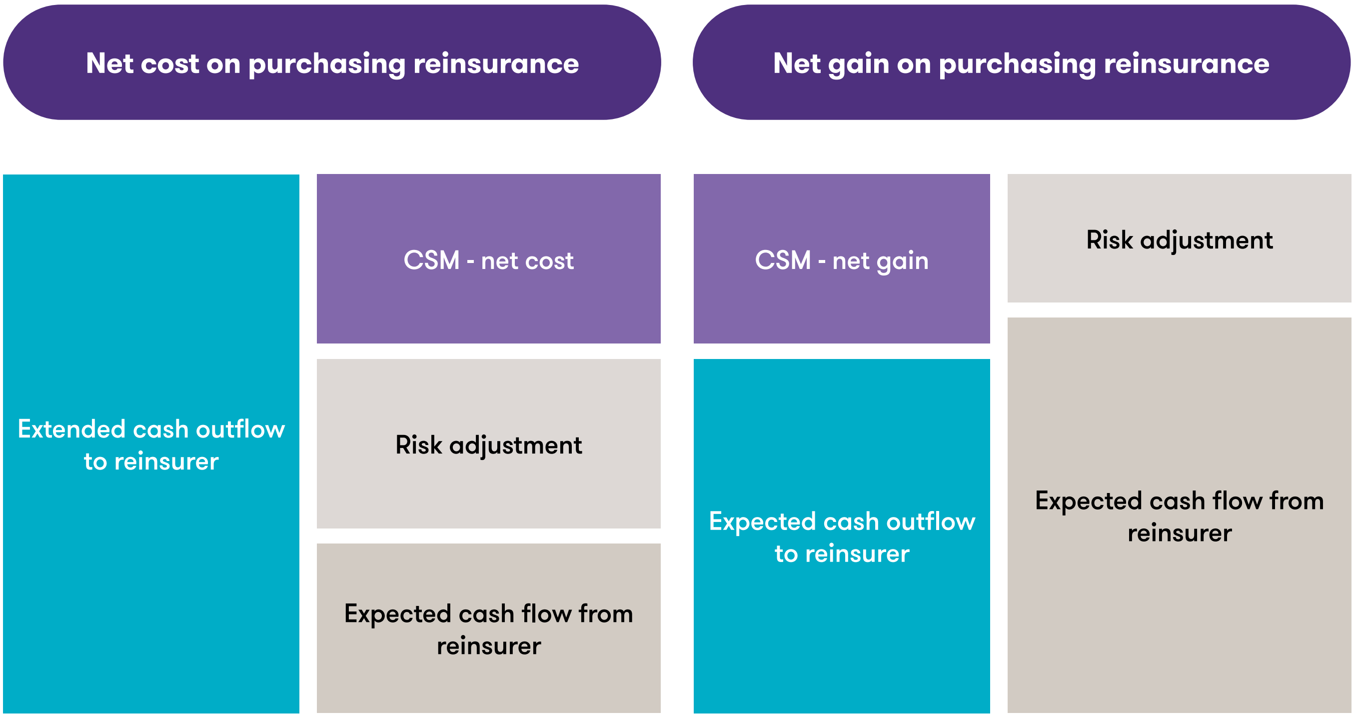
Contractual service margin (CSM)

- The cost of obtaining reinsurance is represented by the contractual service margin for a held reinsurance contract. The contractual service margin for underlying insurance contracts, which represents unearned profit on those contracts, is distinct from this.
- As services are provided under the reinsurance contract held, the cost of obtaining reinsurance is recognised. As an exception, the net cost at initial recognition is recognised right away in profit or loss if the reinsurance contract held covers events that have already happened.
- The cost of reinsurance is often greater than the projected present value of the cash flows that will result from it, plus the risk adjustment for non-financial risk. As a result, the contractual service margin for a group of reinsurance contracts held at initial recognition often corresponds to the net cost of buying reinsurance.
- When expected cash inflows from the reinsurer exceed anticipated cash outflows, plus the risk adjustment for non-financial risk, the contractual service margin for a group of held reinsurance contracts may represent a net gain on reinsurance purchases. In these situations, IFRS 17 treats the initial apparent gain as a reduction in the cost of obtaining reinsurance, or, to put it another way, as though the firm receives a discount on the reinsurance premiums it expects to pay. As a result, the apparent net gain is recognised as a result of the services received under the held reinsurance contract.



- In certain of these circumstances, a business may be expecting to record a loss on the underlying insurance contracts that were issued and a profit on the reinsurance contract that was held at the time of initial recognition. The treatment of an expected loss on the underlying contracts and the apparent net gain upon the initial recognition of a held reinsurance contract is not identical:
  1. On the underlying insurance contracts, an expected loss is recognised right away. As a result, timely information concerning losses associated with those contracts is made available to consumers of the financial statements.
  2. As services are obtained under the reinsurance contract held, a reduction in the cost of reinsurance purchase is acknowledged.
- This is consistent with the principle that expenses are recognised when services are received. This treatment results in the appropriate recognition of the net cost or gain on purchasing reinsurance as the reinsurance services are received.

The contract service margin of a group of held reinsurance contracts is shown in the following example as a net cost on initial recognition and as a net gain on initial recognition.



Premium Allocation Approach (PAA)

In **Para 69** of **IFRS 17 Insurance Contracts incorporating amendments as proposed in Exposure Draft Amendments to IFRS 17** - (herein referred as the 'IFRS 17 Insurance Contract') as:

"An entity may use the premium allocation approach set out in Paragraphs 55–56 and 59 (adapted to reflect the features of reinsurance contracts held that differ from insurance contracts issued, for example, the generation of expenses or reduction in expenses rather than revenue) to simplify the measurement of a group of reinsurance contracts held, if at the inception of the group:

1. The entity reasonably expects the resulting measurement would not differ materially from the result of applying the requirements in Paragraphs 63–68; or

2. The coverage period of each contract in the group of reinsurance contracts held (including insurance coverage from all premiums within the contract boundary determined at that date applying Paragraph 34) is one year or less.

PAA eligibility for reinsurance contract held

The organisation procures reinsurance to cover a group of underlying contracts. It is noteworthy that in this specific case, the reinsurance contract held is the only contract that is part of the group of reinsurance contracts. The contract for the group has a coverage period of two years, which does not conform to the criterion for the premium allocation approach, where the coverage period should be one year or less.

Nevertheless, the group may meet the criterion of the resulting measurement not differing materially from the measurement obtained from the general model, if the entity reasonably expects so, subject to an assessment of relevant facts and circumstances. However, if the entity anticipates a substantial variability in the fulfilment cash flows that would impact the measurement of the reinsurance asset for the remaining coverage before incurring a claim at the inception of the group, then the criterion cannot be met.

GMM	PAA	VFA
There may be a "negative" CSM for reinsurance under non - proportional treaties	The group may meet the criterion of the resulting measurement not the differing materially from the measurement obtained from the general model	Reinsurance contracts are not eligible for the variable fee strategy

Variable Fee Approach (VFA)

Even though the underlying insurance contracts issued are VFA contracts, the VFA conditions are not met for reinsurance contracts held since the entity and the reinsurer do not share the returns on underlying items. When considering the rights and obligations of the company under the reinsurance contract, the contractual service margin for a group of held reinsurance contracts indicates the net cost (or net gain) of acquiring reinsurance. The reinsurer does not provide services relating to investments to the insurer.

If certain requirements are met (the 'risk mitigation option'), IFRS 17 allows an insurer to take into consideration the impact of risk mitigation by allowing it to recognise the change in profit or loss rather than adjusting the CSM for the change in financial risk. Some reinsurance agreements are designed so that the cedant can transfer financial risks associated with its underlying contracts. When the underlying contracts are treated as if they were subject to the variable fee approach, an accounting inconsistency similar to the one previously discussed may occur.

This is because reinsurance contracts are not eligible for the variable fee strategy. Because of this, adjustments to the financial risk of the reinsurance owned are recognised in profit or loss (or other comprehensive income), whereas changes to the financial risk of the underlying contracts are reflected in the CSM

General Measurement Model (GMM)

There is a chance that the held reinsurance contracts won't be able to be valued similarly to the underlying contracts they cover. Given that the bulk of treaty reinsurance contracts are probably for durations longer than a year, (re-)insurers will need to measure their reinsurance using the general measurement model. There may be a 'negative' CSM for reinsurance under non-proportional treaties, which means that gains and losses on the purchase of reinsurance are recognised initially and released to profit or loss over the course of the coverage period. Reinsurance may stretch across more than one portfolio of underlying contracts because it might cover a variety of products, which could result in a mismatch. As they will be based on the coverage acquired from the reinsurer rather than the coverage supplied by the cedant to the underlying policyholders, coverage units may vary.

Profits from underlying policies and reinsurance are recognised at various rates and intervals because of variations in coverage units, contract boundaries, aggregation, and even measurement. Day one losses on the underlying policies are recognised right away, but any profit from non-proportional reinsurance is sometimes considered separately and postponed over the course of the reinsurance contract. Reinsurance and underlying policies should not be viewed as a single concept by (re-)insurers. IFRS 17 considers the recognition and measurement independently, even though they are both still crucial for underlying performance, cash flows, and regulatory capital.

Example of reinsurance

Example of reinsurance

Introduction

An example has been used to elaborate the mechanism of reinsurance under IFRS 17. This example is taken from the 'ifrs-17-reinsurance-contract-held-example.pdf' file available on IFRS official website.

The name of the file is **'Reinsurance contract held: an example of proportionate reinsurance coverage'**

Points below represent the further information of the illustrative example:

- Services provided by the insurer evenly over the contract term.
- All events occur as expected at initial recognition.
- A group of contracts issued three contracts across one-year period with one-year contract term.
- Contract A is issued on 1 January 2021 in Year 1.
- Contract B is issued on 30 June 2021 in Year 1.
- Contract C is issued on 31 December 2021 in Year 1.

The table below shows the assumptions used in the illustration:

Assumptions	Value
Model used	GMM
Risk adjustment	0
Discount rate	0%
Coverage period	2 years
Premium expected on Day 1 for each contract	300

For Company A – Contract issued on 1 Jan 2021

Cashflows

Particulars	01-01-2021	30-06-2021	31-12-2021	30-06-2022	31-12-2022
Premiums	(300)		-	-	-
Claims	-	100	100	-	-

Premium received at issue date

Expected claim payment after 6 months and 12 months after the contract starts

Statement of financial position

Particulars	01-01-2021	30-06-2021	31-12-2021	30-06-2022	31-12-2022
Fulfillment of cashflows	200	100	0	0	0
Contractual service margin (CSM)	100	50	0	**0**	**0**

Future expected payment of claim

(Premium + fulfilment of cashflows) for 01-01-2021 and 50% of it on 30-06-2021

Statement of profit and loss

Particulars	30-06-2021	31-12-2021	30-06-2022	31-12-2022
Expected claims incurred	100	100	-	-
Contractual service margin (CSM)	50	50	-	-
Insurance revenue	**150**	**150**	-	-
Actual claims incurred	(100)	(100)	-	-
Insurance service expense	(100)	(100)	-	-
Insurance service result	**50**	**50**	-	-

Total CSM amortise in two parts

Equivalent to actual claims incurred

Insurance revenue + Insurance service expenses

For Company B – Contract issued on 30 June 2021

Cashflows

Particulars	01-01-2021	30-06-2021	31-12-2021	30-06-2022	31-12-2022
Premiums	-	(300)	-	-	-
Claims	-	-	100	100	-

Statement of financial position

Particulars	01-01-2021	30-06-2021	31-12-2021	30-06-2022	31-12-2022
Fulfillment of cashflows	-	200	100	0	0
Contractual service margin (CSM)	-	(100)	(50)	0	0

(Premium + fulfilment of cashflows) for 30-06-2021 and 50% of it on 31-12-2021

Statement of Profit and Loss

Particulars	30-06-2021	31-12-2021	30-06-2022	31-12-2022
Expected claims incurred	-	100	100	-
Contractual service margin (CSM)	-	50	50	-
Insurance revenue	**-**	**150**	**150**	-
Actual claims incurred	-	(100)	(100)	-
Insurance service expense	-	(100)	(100)	-
Insurance service result	**-**	**50**	**50**	**-**

For Company C – Contract issued on 31 December 2021

Cashflows

Particulars	01-01-2021	30-06-2021	31-12-2021	30-06-2022	31-12-2022
Premiums	-	-	(300)	-	-
Claims	-	-	-	100	100

Statement of financial position

Particulars	01-01-2021	30-06-2021	31-12-2021	30-062022	31-12-2022
Fulfillment of cashflows	-	-	200	100	0
Contractual service margin (CSM)	-	-	(100)	(50)	0

(Premium + fulfilment of cashflows) for 31-12-2021 and 50% of it on 30-06-2022

Statement of profit and loss

Particulars	30-06-2021	31-12-2021	30-06-2022	31-12-2022
Expected claims incurred	-	-	100	100
Contractual service margin (CSM)	-	-	50	50
Insurance revenue	**-**	**-**	**150**	**150**
Actual claims incurred	-	-	(100)	(100)
Insurance service expense	-	-	(100)	(100)
Insurance service result	**-**	**-**	**50**	**50**

For all companies (A, B & C)

Cashflows

Particulars	01-01-2021	30-06-2021	31-12-2021	30-06-2022	31-12-2022
Premiums	(300)	(300)	(300)	-	-
Claims	-	100	200	200	100

Figures here are coming from the combination of the three companies according to their respective heads.

Statement of financial position

Particulars	01-01-2021	30-06-2021	31-12-2021	30-06-2022	31-12-2022
Fulfillment of cashflows	200	300	300	100	-
Contractual service margin (CSM)	(100)	(150)	(150)	(50)	-

Statement of profit and loss

Particulars	**30-06-2021**	**31-12-2021**	**30-06-2022**	**31-12-2022**
Expected claims incurred	100	200	200	100
Contractual service margin (CSM)	50	100	100	**50**
Insurance revenue	**150**	**300**	300	150
Actual claims incurred	(100)	(200)	(200)	**(100)**
Insurance service expense	(100)	(200)	(200)	**(100)**
Insurance service result	**50**	**100**	**100**	**50**

Accounting perspective

Accounting outlook

Reinsurance contact held

The reinsurance contract held is recognised either at the beginning of the coverage period of group reinsurance contacts or the initial recognition of any underlying insurance contract, which ever is later for a proportional treaty. And for a non-proportional treaty, it is recognised at the beginning of the coverage period of a group of insurance contracts.

The assumption used for the reinsurance contract held should be consistent to the underlying contract to estimate the cash flows. The CSM may initially result to either a net cost or net gain of purchasing reinsurance.

The net cost of reinsurance coverage, which is related to an event occurred before the purchase of a reinsurance, is recognised immediately in profit and loss as expenses at initial recognition.

The subsequent measurement of a reinsurance contract held is to recognise the changes in the fulfillment cash flow. An expected loss of any underlying insurance contract is recognised immediately. Similarly, the reduction in the cost of purchasing a reinsurance is recognised as a service received under a reinsurance contract held; this treatment results in the appropriate recognition of net cost or net gain on purchasing reinsurance as the reinsurance services are received.

Subsequent measurement activity	Impacted In
Current or past services	Profit and loss account
Future services	Contractual service margin
Effect of time value of money/financial risk	Profit and loss account and OCI

At the end of the reporting period, the carrying amount of CSM for a group of reinsurance contracts held is adjusted to display changes in estimates as same as the group of insurance contract issued except one modification. Sometimes, the underlying group of insurance contracts might become onerous after the initial recognition because of a negative change in the estimates of fulfillment cash flow of future service and the company recognises the loss on underlying contracts.

But in the reinsurance contact held, the corresponding changes in the cash flow would not adjust the CSM of the group of reinsurance contract held. The impact is that the entity has no net effect of net gain/loss in the profit and loss account to the same extent of change in the fulfillment cash flow of underlying contracts to match with change in the fulfillment cashflow on the group of reinsurance contracts held.

Summary, glossary and references

Summary

In conclusion, IFRS 17 represents a significant change in accounting standards for reinsurance contracts. It aims to enhance transparency, comparability, and consistency in financial reporting within the insurance industry. The implementation of IFRS 17 requires insurers to carefully assess the impact on their reinsurance contracts and adapt their accounting practices accordingly. By introducing a comprehensive framework for recognising, measuring, and disclosing reinsurance contracts, IFRS 17 provides stakeholders with more reliable and relevant information, facilitating better decision-making. However, the transition to IFRS 17 may pose challenges for insurers in terms of data collection, system upgrades, and process adjustments. Overall, IFRS 17 brings greater clarity and accountability to reinsurance contract reporting, benefiting both insurers and their stakeholders.

Glossary

- Ceding organisation – A ceding organisation refers to an insurance or reinsurance company that transfers a portion of its risks and liabilities to another insurance or reinsurance company, known as the reinsurer. The ceding organisation enters into reinsurance agreements with the reinsurer to mitigate its exposure to potential losses arising from the policies it underwrites. By ceding some of the risks, the ceding organisation reduces its overall risk exposure, improves its financial stability, and protects its capital.

- Contractual service margin (CSM) - Contractual service margin is one of the element in the general model that represents the unearned profit the entity will recognise as it provides services in the future.

- Risk adjustment (RA) - Risk adjustment for non-financial risks is the second building block in the general model. It is needed under IFRS 17 to reflect the compensation that a company requires for bearing the uncertainty about the amount and timing of cashflows that arises from a non-financial risk.

- Best estimate liability (BEL) - The best estimate liability, in general, is an estimate of the future cash flows over the life of each contract, i.e., the expected cash flows the insurance company expects to receive and pay in the future. This calculation is based on a best estimate assumption for the future.

- OCI - Other comprehensive income (OCI) refers to a component of a company's financial statements that includes gains, losses, revenues, and expenses that are not recognised in the income statement but are directly recognised in equity. OCI is typically reported as a separate section in the statement of comprehensive income or as a separate statement. It provides a more comprehensive view of a company's financial performance and position by incorporating items that may not be immediately recognised in the income statement.

- P&L – The profit and loss statement details a business's income and expenses over a defined period.

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