Ergebnisbericht des Ausschusses Rechnungslegung und Regulierung
(Report on findings of the Accounting and Regulation Committee)

**IFRS 17 for non-life insurers**

Cologne, 17 August 2018
Preamble

The Accounting and Regulation Committee of the German Association of Actuaries (Deutsche Aktuarvereinigung (DAV) e. V.) has issued the following report on findings to the topic IFRS 17 for non-life insurers.¹

The report is intended to provide assistance to actuaries in the preparation for IFRS 17 and to provide guidance how to apply the new standard in practice.

Issue

The report on findings provides an overview of the new accounting standard and highlights practical challenges and current discussion points. In particular, it is focused on issues requiring a different approach under IFRS 17 as compared to US-GAAP and Solvency II today and illustrates similarities and differences to US-GAAP, Solvency II and German GAAP (HGB).

The report is addressed to actuaries and is focused on providing an overview of the current state of discussions and the insights gained in the sub-working group. It is not a professionally position of the DAV and is meant to support actuaries in actuarial teams.

Adoption

The report on findings was adopted by the DAV’s Accounting and Regulation Committee on 17 August 2018.

¹ The Committee would like to explicitly thank the sub-working group Non-life of the working group IFRS for their work; special thanks also to Stefan Engeländer, Dr. Frederik Boetius and Ingo Behrends for their valuable comments during review phase.
Content

1. Introduction ............................................................................................................. 5

2. Scope and Level of Aggregation ........................................................................ 7

3. Recognition and Measurement ........................................................................ 14
   3.1. Recognition .................................................................................................... 14
   3.2. Overview of liability types and measurement models ................................. 14
   3.3. Applicability of the PAA ............................................................................. 16
   3.4. Contract Boundaries .................................................................................... 18

4. Liability for Remaining Coverage (LRC) – PAA ............................................ 20
   4.1. Initial and subsequent measurement ............................................................. 20
   4.2. Differences to IFRS 4.1 .............................................................................. 23
   4.3. Identification of onerous contracts (OCT) .................................................. 23

5. Liability for Remaining Coverage (LRC) - BBA ............................................. 26
   5.1. Fulfilment cash flows in the LRC................................................................. 26
   5.2. Contractual Service Margin (CSM) ............................................................. 28
   5.3. Accounting the LRC .................................................................................... 32
   5.4. Identification of onerous contracts (OCT) .................................................. 34

6. Liability for Incurred Claim (LIC) ..................................................................... 37
   6.1. Differences to IFRS 4 – US-GAAP or HGB .................................................. 37
   6.2. Estimate of future cash flows (expected value of undiscounted best estimate cash flows) .................................................................................. 38
   6.3. Discounting ................................................................................................... 40
   6.4. Risk Adjustment ............................................................................................ 41
   6.5. Example ......................................................................................................... 41

7. Presentation & Disclosures ................................................................................. 43
   7.1. Balance sheet presentation .......................................................................... 43
   7.2. P&L presentation .......................................................................................... 43
   7.3. Disclosure ..................................................................................................... 44
8. Transition........................................................................................................... 45

8.1. Liability for Remaining Coverage (PAA)........................................... 46
8.2. Liability for Remaining Coverage (BBA)........................................... 46
8.3. Liability for Incurred Claims................................................................. 47

9. Glossary ............................................................................................................. 48
1. Introduction

The international accounting standard “IFRS 17 Insurance Contracts” defines principles for the recognition, measurement, presentation and disclosure of insurance contracts.

Purpose of the present document is to give the reader an introduction to the measurement of non-life insurance contracts under IFRS 17. The document focuses on direct contracts.

In chapter 2 the definition of an insurance contracts and the scope of the standard is explained. Moreover, it provides a four step approach for determining the level or aggregation (also unit of account).

Subsequently, chapter 3 describes the recognition of insurance contracts and provides an overview of the types of liabilities under IFRS 17 and the applicable measurement models. For non-life insurance contracts either the general accounting model, often referred to as building block approach (BBA), or the simplified model for measuring the liability for remaining coverage, the premium allocation approach (PAA), apply. In particular, the requirements for the use of PAA are presented in chapter 3. The specific guidance for insurance contracts with direct participating features, the so-called Variable Fee Approach (VFA), is not discussed in this paper.

In chapter 4, 5 and 6 the measurement models are explained where it is distinguished between liabilities for remaining coverage (LRC) (chapter 4 and 5), which are set up for claims resulting from existing insurance contracts for insured events that have not yet occurred and liabilities for incurred claims (LIC) (chapter 6), which are set up for claims resulting from insured events that have already occurred. Chapter 4 explains the PAA, the simplified approach for the LRC and the related identification of onerous contracts (often called Onerous Contract Test (OCT)). In chapter 5 the BBA is presented, which consists of four building blocks

- Expected present value of (future) best estimate cash flows (Building Block 1 and 2)
- Risk Adjustment for non-financial risks (Building Block 3)
- Contractual Service Margin (CSM) (Building Block 4)

LRC and LIC differ especially with regards to the CSM that is not set up in the LIC.

In chapter 7 the presentation of insurance liabilities, including revenue recognition and recognition of investment expenses, under IFRS 17 is discussed.

The structure of the document is presented in the following illustration.
Figure 1: Overview of document structure
2. **Scope and Level of Aggregation**

IFRS 17.3: An entity shall apply IFRS 17 to
(a) insurance contracts, including reinsurance contracts, it issues;
(b) reinsurance contracts it holds; and
(c) investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

According to IFRS 17.3 the standard is applicable to all written insurance contracts as well as active and passive reinsurance contracts.

IFRS 17 Appendix A defines an *insurance contract* as a contract under which one party accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (insured event) adversely affects the policyholder. Examples for contracts that do explicitly not fall under the scope of IFRS 17 are warranties, employee benefit plans contingent contractual obligations and further contracts as listed in IFRS 17.7.

The definition of an insurance contract is not fundamentally changed compared to the current IFRS 4. However, IFRS 17 contains more detailed requirements to separate components from the host insurance contract that are not distinct and would be within the scope of another IFRS if they were separate contracts: embedded derivatives and investment components (IFRS 9), which rarely occur in non-life insurance contracts\(^2\), as well as service components (IFRS 15). IFRS 17 applies to the remaining host contract after separating these components.

The assessment of significant insurance risk and separating conceptually has to be conducted on the level of the individual contract, even though in practice this would typically be conducted on a more aggregate level.

In contrast, the IFRS 17 guidance on recognition and measurement shall be applied to Groups of Insurance Contracts (GIC), referred to as *unit of account*.

The units of account need to be formed at initial recognition and can be determined by performing a four step approach:

1. Contract combination
2. Portfolio of insurance contracts
3. Annual cohorts
4. Profitability categories

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\(^2\) IFRS 17 refers to issued

\(^3\) Investment components can exist for some commercial insurance contracts or reinsurance contracts
**Step 1: Contract combination**

In a first step it is necessary to assess which contracts are accounted for as one and which need to be separated into components. This assessment is directly affecting the applicable IFRS for each component. If insurance components are separated, each component is treated as if it were a separate contract. In this regard IFRS 17 is aiming to reflect the economic substance and not the legal form of the contract ("substance over form").

**Example:** Bundle Products

Different retail business coverages (e.g. liability, legal protection, household coverage) are sold together. Each component is priced separately and can be bought separately. It needs to be considered whether the components, combined in one contract, are to be considered separately or, if they are legally in different contracts, whether they have to be considered in combination.

**Step 2: Portfolio of Insurance Contracts**

For IFRS 17 a portfolio of insurance contracts (PIC) is defined as insurance contracts subject to similar risks and managed together. In example to allocate a contract to be recognized to a GIC, it is necessary to ensure that all contracts in the GIC belong to the same PIC, i.e. have similar risks and are managed together, as it is understood at that time by the entity. Within this section, some additional interpretations for non-life business on level of aggregation are shared.

The notion "similar risks" is not defined in the standard, but for non-life business we generally interpret the term risks as insurance risks.

IFRS 17.14 states that „contracts within a product line would be expected to have similar risks“, while „contracts in different product lines […] would not be expected to have similar risks“. Although we understand that this is not a rule, but a rebuttable presumption, we believe that the term similar risk can be interpreted in line with the term homogeneous risk used in the Solvency II framework. Consequently, an aggregation of insurance contracts into homogeneous risk groups as under Solvency II could fulfill the requirements for "similar risk" under IFRS 17. However, this has to be analyzed and confirmed individually considering the company specific interpretation and accounting policy.

Special forms of contracts such as bundle products in primary insurance or multi-line contracts in reinsurance might become an issue, particularly if the contracts need to be handled as a whole from a legal point of view or if adjustable features are agreed on an aggregated level. It might be necessary to group these contracts in individual portfolios of insurance contracts for measurement.

The second criterion “managed together“ is also not explicitly defined in the standard. An assessment of “managed together“ requires the internal view of the applying undertaking. From a practical point of view, it could be argued that contracts
are managed together⁴ if they are within the responsibility of e.g. the relevant group CEO, the local CEO or a certain management level.

We assume that dividing the contracts into “similar risks” should usually fulfill the requirement “managed together” for German non-life contracts. This may appear intuitive as insurance companies typically seek to manage similar risks together and it could be argued that, after accounting for risk differences, there are not often significant differences in management approaches. Only, if there are strictly separated responsibilities within a homogeneous risk group (e.g. internal profit responsibility, internal business reporting, pricing settings, etc.), the necessity for further division could arise. In these cases, the criterion “managed together” could require a further separation of this homogeneous risk group.

All in all, we assume that an aggregation of contracts to portfolios according to the Solvency II homogeneous risk group could be a practical and reasonable approach. However, as outlined above, this must be tested individually by each company.

Finally, it should be noted that a certain aggregation of information is necessary for disclosure, e.g. type of contract (e.g. major business line) or geographical area (e.g. country or region). Generally, it cannot be assumed that the derived granularity of the portfolios of insurance contracts automatically fulfils the disclosure requirements, which could lead to the need of a further aggregation / allocation of information for disclosure.

Step 3: Annual cohorts

Entities need to determine bottom-up annual cohorts (i.e., no grouping of contracts that are issued more than 12 months apart). This does not necessarily require a split based on calendar year / reporting period.

In many cases, the issue date and the date of initial recognition of a contract may deviate. In such cases, the insurer needs to assess what date should be used for the grouping. While the wording of the standard refers to the issue date, we think that a grouping based on the date of initial recognition is also acceptable under IFRS 17:

- Rationale for annual cohorts: The IASB was concerned that a CSM determination based on perpetual open portfolios could lead to the CSM persisting beyond the duration of contracts in the group. Consequently, in addition to dividing contracts into GICs based on the contracts’ profitability, the IASB decided to require a split of portfolios into annual cohorts. The IASB’s objective would be achieved by either way of determining annual cohorts.

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⁴ We note that “managed together” is defined in IFRS 9. The concept should consistently be applied for both standards.
• Reference to the date of initial recognition is consistent with the overall grouping approach. In particular, the profitability grouping (see step 4) also refers to the date of initial recognition.

The following example illustrates the implications:

Let’s consider a German motor vehicle liability portfolio consisting of the following contracts:

Contract 1: A customer is registering his car on 2/1/2021 using an electronic insurance certificate issued by company A based on an offer of coverage from registration date until the end of the calendar year. The contract is subject to automatic yearly renewal if not explicitly cancelled either by the customer or the company by the end of November. Issuing date of the contract would be 2/1/2021, coverage period 2/1/2021 – 31/12/2021.

Contract 2: Contract 1 is not cancelled. So a new contract enters in force by 1/12/2021. Issuing date of this contract would be 1/12/2021, coverage period 1/1/2022 – 31/12/2022.

Contract 3: Company A accepts a proposal by a new customer on 1/9/2021 on coverage from 1/1/2022 until 31/12/2022. Issuing date of this contract would be 1/9/2021, coverage period 1/1/2022 – 31/12/2022.

<table>
<thead>
<tr>
<th>Contract No.</th>
<th>Issuing date</th>
<th>Beginning of coverage period</th>
<th>End of coverage period</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2/1/2021</td>
<td>2/1/2021</td>
<td>31/12/2021</td>
</tr>
<tr>
<td>2</td>
<td>1/12/2021</td>
<td>1/1/2022</td>
<td>31/12/2022</td>
</tr>
<tr>
<td>3</td>
<td>1/9/2021</td>
<td>1/1/2022</td>
<td>31/12/2022</td>
</tr>
</tbody>
</table>

The same profitability is expected for all of these contracts. If Company A was grouping its contracts of portfolio profitability classes by calendar year of issuing date all of these contracts would belong to the group “Motor Liability Insurance - Profitability Class X - Issuing Year 2021”. The beginning of the coverage period of this group would be 2/1/2021. Assumed that the first payment is due at the beginning of the coverage period for all contracts the initial recognition date of the group would be 2/1/2021. The group as a whole would have to be taken into account at the reporting date 31/12/2021.

If Company A was grouping its contracts of portfolio profitability classes by calendar year of beginning of the coverage period only contract 1 would belong to the group G1: “Motor Liability Insurance - Profitability Class X – Beginning of Coverage
Year 2021”. Contract 2 and 3 would belong to the group G2: “Motor Liability Insurance - Profitability Class X – Beginning of Coverage Year 2022”. Initial recognition date of group G1 would be 2/1/2021. The initial recognition date of group G2 could lie between 1/9/2021 and 31/12/2021 if the group becomes onerous within this period and 1/1/2022 if not. Depending on that the group would have to be taken into account at the reporting date 31/12/2021 or not.

<table>
<thead>
<tr>
<th>Cohort determined by</th>
<th>Group No.</th>
<th>Beginning of coverage period of the group</th>
<th>End of coverage period of the group</th>
<th>Initial recognition date of group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issuing date of contract</td>
<td>1</td>
<td>2/1/2021</td>
<td>31/12/2022</td>
<td>2/1/2021</td>
</tr>
<tr>
<td>Beginning of coverage period of contract</td>
<td>1</td>
<td>2/1/2021</td>
<td>31/12/2021</td>
<td>2/1/2021</td>
</tr>
<tr>
<td>Beginning of coverage period of contract</td>
<td>2</td>
<td>1/1/2022</td>
<td>31/12/2022</td>
<td>Group not onerous: 1/1/2022 Group onerous: When the group becomes onerous between 1/9/2021 – 31/12/2021</td>
</tr>
</tbody>
</table>

**Step 4: Profitability categories (Identification of onerous contracts (OCT))**

<table>
<thead>
<tr>
<th>IFRS 17.16: An entity shall divide a portfolio of insurance contracts issued into a minimum of:</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) a group of contracts that are onerous at initial recognition, if any;</td>
</tr>
<tr>
<td>(b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and</td>
</tr>
<tr>
<td>(c) a group of the remaining contracts in the portfolio, if any.</td>
</tr>
</tbody>
</table>

According to IFRS 17.16 the contracts must be divided at least into these three categories of profitability.
IFRS 17.17 requires an assessment which contracts are expected to have a similar profitability. The assessment should be based on reasonable and supportable information. Which information is reasonable and supportable depends on the data availability and quality. The granularity of the available (actuarial) assumptions is expected to be a restricting factor. The assessment should be performed on a regular basis.

IFRS 17.47: An insurance contract is onerous at the date of initial recognition if the fulfilment cash flows allocated to the contract, any previously recognized acquisition cash flows and any cash flows arising from the contract at the date of initial recognition in total are a net outflow.

Applying paragraph 16(a), an entity shall group such contracts separately from contracts that are not onerous.

To the extent that paragraph 17 applies, an entity may identify the group of onerous contracts by measuring a set of contracts rather than individual contracts.

The flagging of the contracts as onerous is the result of the measurement as described in IFRS 17.47. Contracts with a total net outflow must be classified as onerous at recognition.

IFRS 17 generally requires applying the differentiation in the categories on an individual contract basis. But under the condition of IFRS 17.17 the measurement can be based on set of contracts. It is expected that especially in retail business IFRS 17.17 will be applicable and the calculation will be based on sets of contracts.
IFRS 17.18 states as a basic and starting assumption that contracts measured via the PAA approach should be assumed as not onerous, unless facts and circumstances indicate otherwise. Such facts and circumstances could be derived for example from the reserving results, although this should not be the only source of information. If there is a sustainable indication that a group of contracts has been onerous in the past, while the product design and pricing remained unchanged, this could be a sufficient indication to flag the new business as onerous.

Therefore, it will be necessary to implement appropriate processes to consider such facts and circumstances when present to classify the contracts as onerous or being without a significant possibility of becoming onerous.
3. Recognition and Measurement

3.1. Recognition

**IFRS 17.25:** An entity shall recognize a group of insurance contracts it issues from the earliest of the following:
(a) the beginning of the coverage period of the group of contracts;
(b) the date when the first payment from a policyholder in the group becomes due; and
(c) for a group of onerous contracts, when the group becomes onerous.

If there is no contractual due date, the first payment for the policyholder is deemed to be due when it is received (IFRS 17.26).

3.2. Overview of liability types and measurement models

**IFRS 17.40:** The carrying amount of a group of insurance contracts at the end of each reporting period shall be the sum of
(a) the **liability for remaining coverage** comprising
   i. the fulfilment cash flows related to future service allocated to the group at that date, measured applying paragraphs 33-37 and B36-B92;
   ii. the contractual service margin of the group at that date, measured applying paragraphs 43-46; and
(b) the **liability for incurred claims**, comprising the fulfilment cash flows related to past service allocated to the group at that date, measured applying paragraphs 33-37 and B36-B92.

In general, IFRS 17 splits the measurement of the insurance contract in two liabilities:

- Liability for Remaining Coverage (**LRC**) for the obligation to pay for claims under existing insurance contracts for insured events that have not yet occurred (i.e. the obligation that relates to the unexpired portion of the coverage period) (IFRS 17 Appendix A). The LRC may be as well in an asset position, particularly due to acquisition cost.

- Liability for Incurred Claims (**LIC**) for obligations to pay for claims for insured events that have already occurred, including not yet reported claims (IBNR) (IFRS 17 Appendix A). In very rare cases as well the LIC may be in an asset position, e.g. due to salvage or subrogation.

**IFRS 17.29:** An entity shall apply paragraphs 30-52 to all groups of insurance contracts within the scope of IFRS 17, with the following exceptions:
(a) For groups of insurance contracts meeting either of the criteria specified in paragraph 53, an entity may simplify the measurement of the group using the premium allocation approach in paragraphs 55-59.
The general accounting model for LRC as well as LIC is the so called Building Block Approach (BBA), where according to IFRS 17.32 the liability is calculated based on

- the **fulfilment cash flows**, which correspond to estimates expected present values of future cash flows (including any adjustment for financial risk) and a risk adjustment for non-financial risks (**RA**).

- the contractual service margin (**CSM**).

For measurement the cash outflows will be allocated to LIC and LRC (IFRS 17.40) depending whether they relate to

- incurred, but not reported or not yet finally regulated claims or
- future claims expected to incur in the coverage period.

For non-life contracts premiums are normally the only inflow (except salvage or subrogation).

Following IFRS 17.29 the insurer has the option to apply the **PAA** to the LRC if the corresponding requirements are fulfilled (see chapter 3.3). When applying the PAA the entity is not required to discount the LIC if the underlying cash flows are expected to be paid or received in one year or less from the date the claims occur (IFRS 17.56). Further details on the PAA will be provided in chapter 4.

The following illustration provides an overview of the measurement models.

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**Figure 2**: Overview of measurement models
Please note for the recognition of the time value of money IFRS 17 provides an accounting policy choice to recognize changes in discount rates in P&L or OCI\(^5\) (OCI option) (IFRS 17.88). When the insurer decides to apply the OCI option, the impact due to change in interest rate, which is recognized in OCI, is calculated as difference of the best estimate cash flows discounted at current rate and the best estimate cash flows discounted at the rate locked-in at initial recognition of the GIC (IFRS 17.B72(e)(ii)), representing a weighted average of the applied rate curves when grouping the included contracts. However, if applying the PAA the interest rate is locked-in at the date when the respective claim occurs (IFRS 17.B72(e)(iii)).

Consequently, in case the OCI option is applied, the choice of the measurement model impacts the timing for locking in the interest rate and correspondingly the cutting and granularity of the fulfilment cash flows. In particular, when the BBA is applied for LRC and LIC the interest rate is locked-in at initial recognition which requires structuring the data with respect to the initial recognition periods (IFRS 17.25) for discounting.

3.3. **Applicability of the PAA**

**IFRS 17.53:** An entity may simplify the measurement of a group of insurance contracts using the premium allocation approach set out in paragraphs 55-59 if, and only if, at the inception of the group:
(a) the entity reasonably expects that such simplification would produce a measurement of the liability for remaining coverage for the group that would not differ materially from the one that would be produced applying the requirements in paragraphs 32-52; or,
(b) the **coverage period** of each contract in the group (including coverage arising from all premiums within the contract boundary determined at that date applying paragraph 34) **is one year or less**.

**IFRS 17.54:** The criterion in paragraph 53(a) is not met if at the inception of the group an entity expects significant variability in the fulfilment cash flows that would affect the measurement of the liability for remaining coverage during the period before a claim is incurred. Variability in the fulfilment cash flows increases with, for example:
(a) the extent of future cash flows relating to any derivatives embedded in the contracts: and
(b) the length of the coverage period of the group of contracts.

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\(^5\) Other Comprehensive Income: Includes all elements of comprehensive income except for net income (direct impact on equity)
As the applicability of the PAA is part of the guidance on measurement, the assessment has to be conducted on the level of the group of contracts.

The coverage period in criterion IFRS 17.53(b) does not refer to legal terms, but to the contract boundaries as defined by IFRS 17. Please refer to chapter 3.4. for more details. IFRS 17.53(b) requires "each contract in the group" to have a coverage period of one year or less. In practice, it would be expected that a threshold for an acceptable number of contracts with a coverage period of more than one year is defined in the entity's accounting policy, based on a materiality concept.

For the assessment of criterion IFRS 17.53(a), two potential sources of deviations in the measurement of the LRC between PAA and BBA need to be considered:

(i) expected assumptions changes resulting in variability of fulfilment cash flows, and
(ii) the revenue recognition pattern.

Assumptions changes:

- At initial recognition, both approaches by definition will not result in differences.
- For subsequent measurement, the LRC under the PAA is implicitly based on locked-in assumptions. Discounting or accretion of interest only applies if the contract contains a significant financing component. If this is the case, the interest rate locked-in at the contract inception date is applied.
- Under the BBA, the LRC is always based on fully current assumptions. Thus, any changes in assumptions can potentially result in deviations from the LRC under the PAA. However, changes in non-financial assumptions adjust the CSM, which is also part of the LRC. Such changes thus only affect the split between fulfilment cash flows and CSM, but leave the overall LRC unchanged, but may change future revenue recognition patterns. In contrast, changes in financial assumptions do not adjust the CSM and thus produce potential differences compared to the PAA. The most critical variable in this regard is the interest rate: changes in interest rates occur regularly and they can produce significant variability in fulfilment cash flows, in particular for contracts with a long coverage period and/or settlement period.

Revenue recognition pattern:

- Under the PAA, revenue is determined by allocating the premium to periods based on the passage of time or on the basis of the expected timing of incurred insurance service expenses if this pattern is expected to differ significantly from a linear release.
- Under the BBA, different release patterns apply to the different building blocks.

Figure 3 summarizes the discussion:
3.4. **Contract Boundaries**

**IFRS 17.34:** Cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity can compel the policyholder to pay the premiums or in which the entity has a substantive obligation to provide the policyholder with services (see paragraphs B61-B71). A substantive obligation to provide services ends when:

(a) the entity has the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects those risks; or

(b) the pricing of the premiums for coverage up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date.

The following table lists cash flows which are related to the fulfilment of the contracts and therefore may be considered in measurement if within the contract boundary and other cash flows:
<table>
<thead>
<tr>
<th>CFs within the contract boundaries</th>
<th>CFs outside the contract boundaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>- premiums</td>
<td>- investment returns that do not affect the cash flows of the insurance contracts</td>
</tr>
<tr>
<td>- payments to (or on behalf of) the policyholder</td>
<td>- cash flows that arise under reinsurance contracts held</td>
</tr>
<tr>
<td>- directly attributable acquisition costs</td>
<td>- cash flows from future insurance contracts</td>
</tr>
<tr>
<td>- claim handling costs</td>
<td>- costs that are not directly attributable</td>
</tr>
<tr>
<td>- cost the entity will incur in providing contractual benefits paid in-kind</td>
<td>- cash flows that arise from abnormal amounts of wasted labor or other resources that are used to fulfil the contract</td>
</tr>
<tr>
<td>- cash flows resulting from options and guarantees (if not separated from the host)</td>
<td>- income tax payments/receipts the insurer does not receive in a fiduciary capacity</td>
</tr>
<tr>
<td>- policy administration and maintenance costs</td>
<td>- cash flows between different components of the reporting entity, such as policyholder funds and shareholder funds</td>
</tr>
<tr>
<td>- transaction-based taxes</td>
<td>- cash flows arising from components separate from the insurance contract and accounted for using other applicable standards</td>
</tr>
<tr>
<td>- fiduciary payments made by the insurer to meet tax obligations</td>
<td></td>
</tr>
<tr>
<td>- recoveries (salvage or subrogation)</td>
<td></td>
</tr>
<tr>
<td>- cash inflows related to requirements to share returns on underlying items or transfer cash flows</td>
<td></td>
</tr>
<tr>
<td>- directly attributable fixed or variable overhead costs</td>
<td></td>
</tr>
</tbody>
</table>

Table 1 Overview of cash flows which are related or not related to the fulfilment of contracts
4. Liability for Remaining Coverage (LRC) – PAA

4.1. Initial and subsequent measurement

**IFRS 17.55:** Using the premium allocation approach, an entity shall measure the liability for remaining coverage as follows:

(a) on initial recognition, the carrying amount of the liability is:
   i. the **premiums**, if any, **received** at initial recognition;
   ii. **minus** any insurance **acquisition cash flows** at that date, unless the entity chooses to recognize the payments as an expense applying paragraph 59(a); and
   iii. **plus or minus** any amount arising from the derecognition at that date of the asset or liability **recognized for insurance acquisition cash flows** applying paragraph 27.

(b) at the end of each subsequent reporting period, the carrying amount of the liability is the **carrying amount at the start** of the reporting period:
   i. plus the **premiums received** in the period;
   ii. **minus** insurance **acquisition cash flows**; unless the entity chooses to recognize the payments as an expense applying paragraph 59(a);
   iii. **plus** any amounts relating to the **amortization of insurance acquisition cash flows** recognized as an expense in the reporting period; unless the entity chooses to recognize insurance acquisition cash flows as an expense applying paragraph 59(a);
   iv. **plus** any **adjustment to a financing component**, applying paragraph 56;
   v. **minus** the amount recognized as insurance **revenue** for coverage provided in that period (see paragraph B126); and
   vi. **minus** any **investment component** paid or transferred to the liability for incurred claims.

In the following we will provide further details on each calculation component for the PAA.

**Premiums received (i)**

IFRS 17 does not distinguish between due or undue cash flows, but only between received and future cash flows. As a consequence, the premium recognition for calculating the LRC under IFRS 17 is based on **premiums received**. This approach is different from the ultimate premium concept. To illustrate the difference we have set up the following example.

**Example A:**

- Liability insurance with coverage period of one year, starting from 01/12/x.
- Annual premium of €600 due at 01/12/x.
- Premium payment at 05/01/x+1.
• Risk coverage is allocated linearly over the coverage period.

<table>
<thead>
<tr>
<th>“Ultimate premium” concept:</th>
<th>“Premiums received” concept:</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/12/x</td>
<td>31/12/x</td>
</tr>
<tr>
<td>Gross premiums written</td>
<td>Premiums received</td>
</tr>
<tr>
<td>- Premiums earned</td>
<td>- Premiums earned</td>
</tr>
<tr>
<td>= Unearned premium reserve</td>
<td>= Unearned premium reserve</td>
</tr>
<tr>
<td>Premium receivable</td>
<td>(= Asset!)</td>
</tr>
<tr>
<td>Cash</td>
<td>Cash</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>31/03/+1</td>
<td>31/03/+1</td>
</tr>
<tr>
<td>Unearned premium reserve – previous period</td>
<td>Unearned premium reserve – previous period</td>
</tr>
<tr>
<td>+ Additional gross premiums written</td>
<td>+ Additional premiums received</td>
</tr>
<tr>
<td>- Premiums earned</td>
<td>- Premiums earned</td>
</tr>
<tr>
<td>= Unearned premium reserve</td>
<td>= Unearned premium reserve</td>
</tr>
<tr>
<td>Premium receivable</td>
<td>Premium receivable</td>
</tr>
<tr>
<td>Cash</td>
<td>Cash</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Figure 4** Comparison ultimate premium concept and premiums received concept

Please refer to chapter 7 for more details how this interacts with the requirements on balance sheet presentation.

**Insurance acquisition cash flows (ii/iii)**

Insurance **acquisition cash flows** are defined as cash flows arising from the costs of selling, underwriting and starting a group of insurance contracts that are directly attributable to the portfolio of insurance contracts to which the group belongs (IFRS 17 Appendix A). IFRS 17.B125 requires allocating these cash flows for revenue recognition over the coverage period in a systematic way on the basis of the passage of time.

Under the PAA, this corresponds to a deferral of insurance acquisition cash flows and a linear amortization over the coverage period. As a simplification, under the PAA entities are permitted to expense insurance acquisition cash flows as incurred if the coverage period of each contract in the group at initial recognition is no more than one year (IFRS 17.59(a)).

**Significant financing component (iv)**

IFRS 17.56: If insurance contracts in the group have a **significant financing component**, an entity shall adjust the carrying amount of the liability for remaining coverage to reflect the time value of money and the effect of financial risk using the discount rates specified in paragraph 36, as determined on initial recognition. The entity is not required to adjust the carrying amount of the liability for remaining coverage to reflect the time value of money and the effect of financial risk if, at initial recognition, the entity expects that the time between providing each part of the coverage and the related premium due date is no more than a year.
IFRS 17 does not define **significant financing components**, however, IFRS 15 does.

As a practical expedient, IFRS 17 allows entities not to apply discounting if the time between providing each part of the coverage and the corresponding premium due date is no more than one year:

**Insurance revenue recognition (v)**

**IFRS 17.B126:** When an entity applies the premium allocation approach in paragraphs 55-58, **insurance revenue** for the period is the amount of expected premium receipts (excluding any investment component and adjusted to reflect the time value of money and the effect of financial risk, if applicable, applying paragraph 56) allocated to the period. The entity shall allocate the expected premium receipts to each period of coverage:

(a) on the basis of the **passage of time**; but

(b) if the **expected pattern of release** of risk during the coverage period differs significantly from the passage of time, then on the basis of the expected timing of incurred insurance service expenses.

IFRS 17.B126 requires allocating expected premium receipts over the coverage period. Thus, in contrast the premium deferral under (i), **revenue recognition** is based on the ultimate premium under the contract.

For non-distinct **investment component** (vi) please refer to chapter 7.

4.2. **Differences to IFRS 4.1**

The determination of the LRC under the PAA as discussed in chapter 4.1 is conceptually similar to the Unearned Premium Reserve (**UPR**) under IFRS/US-GAAP reporting (and "Beitragsüberträge" under HGB). The following table provides an overview of the differences between the accounting standards.
When applying the PAA, the LRC must be increased for a loss component reflecting the expected losses.

**IFRS 17.18:** For contracts issued to which an entity applies the premium allocation approach (see paragraphs 53–59), the entity shall **assume no contracts in the portfolio are onerous at initial recognition, unless facts and circumstances indicate otherwise.** An entity shall assess whether contracts that are not onerous at initial recognition have no significant possibility of becoming onerous subsequently by assessing the likelihood of changes in applicable facts and circumstances.

**IFRS 17.57:** If at any time during the coverage period, facts and circumstances indicate that a group of insurance contracts is onerous, an entity shall calculate the difference between:

(a) the carrying amount of the liability for remaining coverage determined applying paragraph 55;

(b) the fulfilment cash flows that relate to remaining coverage of the group, applying paragraphs 33-37 and B36-B92. However, if, in applying paragraph 59(b), the entity does not adjust the liability for incurred claims for the time value of money and the effect of financial risk, it shall not include in the fulfilment cash flows any such adjustment.

**IFRS 17.58:** To the extent that the fulfilment cash flows described in paragraph 57(b) exceed the carrying amount described in paragraph 57(a), the entity shall recognize a loss in profit or loss and **increase the liability for remaining coverage.**
This triggers two questions:

(i) When / how frequently should the onerous contract test be conducted?

An onerous contract test should be conducted any time during the coverage period, if "facts and circumstances" indicate that a group of contracts is onerous. There is no further specification in IFRS 17 regarding facts and circumstances. Determination of facts and circumstances is a qualitative assessment. This means insurance companies would need to assess facts and circumstances for business in force and identify changes to facts and circumstances in subsequent years during the coverage period in order to assess whether there are indications for onerous contracts in the business in force.

(ii) How shall the loss component be determined?

If facts and circumstances indicate that a contract is onerous IFRS 17.57 requires comparing the group's fulfilment cash flows as determined under the BBA with the LRC as determined under the PAA.

For the method required under (ii) a conceptually similar approach to determining premium provisions cash-outflows under Solvency II might be acceptable under IFRS 17 for determining a loss component, due to largely analogous regulatory requirements. This allows the existing Solvency II processes to be reused for IFRS 17. The procedure up to the determination of the discounted fulfilment cash flows ("present value BE-CFs") is identical to the procedure under SII, whereby the individual components such as Combined Ratio may deviate between Solvency II and IFRS 17. The only major procedural change is the consideration of risk adjustment as part of the fulfilment cash flows. Figure 5 illustrates the methodology, which shows the conceptual similarities to premium provision cash-outflows under Solvency II:

![Figure 5](image)

**Figure 6** Onerous contract test versus premium provision approach under Solvency II

The other major change concerns granularity raised by question (i). Consistent with this IASB rationale for introduction of the PAA and for ensuring of value-adding information in the context of onerous contracts, we would propose that “facts and circumstances” should be mainly based on the segmentation and information available in the finance function:

- Information and processes in scope of the regular IFRS audit (e.g., accounting and reserving data and processes).
• Internally reconciled data from the planning dialogue and local controlling LoBs.
• Enhancement by additional information, which means not to disregard information generated by routine reporting and governance processes which might suggest that sets of contracts are onerous or have a significant risk of becoming onerous (“red flag information”).

For the red flag information an identification process is necessary, which takes care that all relevant information regarding facts and circumstances comes to the attention of relevant stakeholders. This process should be updated whenever there might be changes in the relevant facts and circumstances, leading e.g. to new KPIs. Ideally, those facts and circumstances are defined in a way that the calculation of the loss component, which is necessary then, results indeed in a loss component.
5. Liability for Remaining Coverage (LRC) - BBA

At each valuation date the LRC is set up for a particular unit of account. The default method under IFRS 17 is the so called BBA (Building Block Approach) (see chapter 3.2). The LRC consists of two components: the fulfilment cash flows that refer to open coverage and the contractual service margin (CSM).

The present chapter provides details on the fulfilment cash flows in the first section and describes the concept of the CSM in the second section. The third section refers to the LRC as a whole.

5.1. Fulfilment cash flows in the LRC

IFRS 17.32: 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 (paragraphs 33 – 35);
   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 (paragraph 36); and
   iii. a risk adjustment for non-financial risk (paragraph 37).

(b) the contractual service margin (CSM), measured applying paragraphs 38-39.

The fulfilment cash flows include all future cash flows within the boundary of the contract. Payments in past period(s) are not included. The fulfilment cash flows are the sum of cash inflows and cash outflows with the following sign convention: on the liability side outflows are positive and inflows are negative.

Based on the occurrence of the corresponding claims the cash flows are split between LRC and LIC (see chapter 3.2 for further details). The relevant cash flows for the LRC can prospectively be determined for each future valuation date. For this purpose not only amount and timing of the expected payments must be considered, but also the occurrence of the according claims. This is necessary for the presentation of changes in the LRC in the required granularity.

Example B:

- Contractual term: 01/01/x to 31/12/x.
- It is assumed that all claims of the contract are settled within two quarters. The claim amount per accident quarter is €150.
• One third of the claim payments are attributable to the accident quarter, two third are attributable to the following quarter.
• The total premium amount is €1,200, whereof €200 is expected as adjustment premium.
• Discounting, and risk adjustment are neglected.
• Valuation date is 31/03/x.

Based on these assumptions the fulfilment cash flows are as follows:

<table>
<thead>
<tr>
<th>Cash flows (in €)</th>
<th>Payments (expected)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>30/06/x</td>
</tr>
<tr>
<td>Claims</td>
<td></td>
</tr>
<tr>
<td>Quarter 1</td>
<td>100</td>
</tr>
<tr>
<td>Quarter 2</td>
<td>50</td>
</tr>
<tr>
<td>Quarter 3</td>
<td>50</td>
</tr>
<tr>
<td>Quarter 4</td>
<td>50</td>
</tr>
<tr>
<td>Premium</td>
<td></td>
</tr>
</tbody>
</table>

In the first quarter the premium of €1,200 and one third of the claim attributable to quarter 1 (€50) was already paid. The future fulfilment cash flows result in the following LRC/LIC cash flows as at 31/03/x:

<table>
<thead>
<tr>
<th>31/03/x (in €)</th>
<th>Total</th>
<th>Thereof: due in Quarter 2</th>
<th>Thereof: projected outflows related to future services following period</th>
<th>Thereof: projected LIC following period</th>
</tr>
</thead>
<tbody>
<tr>
<td>LIC - Outflows</td>
<td>100</td>
<td>100</td>
<td></td>
<td></td>
</tr>
<tr>
<td>LRC - Outflows</td>
<td>450</td>
<td>50</td>
<td>300</td>
<td>100</td>
</tr>
<tr>
<td>LRC - Inflows</td>
<td>-200</td>
<td></td>
<td>-200</td>
<td></td>
</tr>
</tbody>
</table>
5.2. Contractual Service Margin (CSM)

**IFRS 17.38:** The contractual service margin is a component of the asset or liability for the group of insurance contracts that represents the unearned profit the entity will recognize as it provides services in the future. An entity shall measure the contractual service margin on initial recognition of a group of insurance contract at an amount that, unless paragraph 47 (on onerous contracts) applies, results in no income or expenses arising from:

(a) the initial recognition of an amount for the fulfilment cash flows, measured by applying paragraphs 32-37;

(b) the derecognition at the date of initial recognition of any asset or liability recognized for insurance acquisition cash flows applying paragraph 27; and

(c) any cash flows arising from the contracts in the group at that date.

As stated in IFRS 17.38 the contractual service margin (CSM) represents the unearned profit the entity will recognize as it provides services under the insurance contract/group of insurance contracts.

**Initial recognition:** The CSM is calculated prospectively at initial recognition and then rolled forward until the end of the coverage period (IFRS 17.38, IFRS 17.43-46).

- If the GIC is profitable at initial recognition the fulfilment cash flows less pre-payments are negative and the CSM is set to
  
  Initial CSM = pre-payments – fulfilment cash flows

  Pre-payments can be acquisition costs allocated to the portfolio or pre-paid premiums. Consequently, the CSM at initial recognition neutralizes possible gains for expected future profits in the P&L.

- If the GIC is onerous at initial recognition, the CSM is set to zero.

**Subsequent Measurement:** The CSM is rolled forward in three steps (IFRS 17.44):

Starting point is the CSM at the start of the reporting period or, if the portfolio has been incepted within the reporting period, the CSM at initial recognition, which is adjusted for

- the effect of new contracts added to the GIC

- interest accreted during the reporting period measured by applying the discount rate as at recognition date of the GIC (locked-in interest rate).

- changes in estimates for the LRC relevant cash flows and experience variance arising from premiums received in the period that relate to future service and related cash flows with the following two exceptions:
Would the adjustment result in a negative CSM, i.e. an expected loss for the remaining coverage period, the CSM is set to zero. The corresponding amount due to the change in estimate/experience variance that cannot be offset against the CSM must be recognized as a loss in the P&L.

If the change in estimate/experience variance is negative, which corresponds to future expected profits, it will first be used to compensate losses from the previous periods (allocated to the loss component) and will be recognized as profit in the P&L\(^6\). Any remaining amount increases the CSM.

- the amount recognized as insurance revenue due to transfer of services in the period. This means the remaining CSM is allocated over time based on a currently determined pattern. The amount to be allocated to the current period is based on the coverage units in the GIC that is determined by considering the benefits provided and the expected coverage duration.

**Example C:**

- For the contract in example B the attributable acquisition costs are €120.
- At initial recognition the assumptions result in a CSM of €480:
  \[
  \text{€480} = 0 \text{ (pre-CF w/o acquisition costs) } - [\text{€1,200 (inflows)} + \text{€600 (outflows)} + \text{€120 (acquisition costs)}] 
  \]
- Interest and risk adjustment are still neglected.
- The first quarter is as expected.
- In the second quarter the claim payments and the expected claims increase to €240 and result in the following pattern:

<table>
<thead>
<tr>
<th>Cash flows (in €)</th>
<th>Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>30/06/x actual</td>
</tr>
<tr>
<td>Claims</td>
<td></td>
</tr>
<tr>
<td>Quarter 1</td>
<td>100</td>
</tr>
<tr>
<td>Quarter 2</td>
<td>90</td>
</tr>
<tr>
<td>Quarter 3</td>
<td></td>
</tr>
<tr>
<td>Quarter 4</td>
<td></td>
</tr>
<tr>
<td>Premium</td>
<td></td>
</tr>
</tbody>
</table>

The CSM per 30/06 is €120, which results from the following roll forward:

<table>
<thead>
<tr>
<th>CSM roll forward (in €)</th>
<th>CSM</th>
<th>Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>01/01/x</td>
<td>480</td>
<td></td>
</tr>
</tbody>
</table>

\(^6\) As negative expense – compensating the past expense already recognized at establishing the loss component.
In this example the claim experience in the second quarter leads to an increase in expected and actual total claims for quarter 2, 3 and 4 from €150 to €240. Correspondingly, the profit expectation for quarters 2 to 4 is no longer €120, but only €30 on average:

- In the second quarter the release of CSM results in a profit contribution of €60.
- With claims of €90 in the second quarter there is an overall loss of €30.
- The CSM includes the expected future profits for quarter 3 and 4 of €120, which results in an average profit of \((€120 - €30)/3 = 30\).

The profit is allocated more evenly if the second and third step are changed in the roll forward, e.g. perform first the release of CSM and recognize changes in estimate subsequently. The corresponding alternative roll forward is presented in the below example.

**Example C.1:**

<table>
<thead>
<tr>
<th>CSM roll forward in €</th>
<th>CSM</th>
<th>Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>01/01/x</td>
<td>480</td>
<td></td>
</tr>
<tr>
<td>31/03/x</td>
<td></td>
<td>-120</td>
</tr>
<tr>
<td>31/03/x</td>
<td>360</td>
<td></td>
</tr>
<tr>
<td>30/06/x</td>
<td></td>
<td>-120</td>
</tr>
<tr>
<td>30/06/x</td>
<td></td>
<td>300</td>
</tr>
<tr>
<td>30/06/x</td>
<td></td>
<td>480</td>
</tr>
<tr>
<td>30/06/x</td>
<td></td>
<td>-180</td>
</tr>
<tr>
<td>30/06/x</td>
<td>60</td>
<td></td>
</tr>
</tbody>
</table>

The alternative roll forward approach results in the same overall profit, but is allocated as follows to each quarter:
Quarter 2: €30,
CSM (profit projection for quarter 3 and 4): €60.

According to IFRS 17.44(e) the roll forward is to be performed as presented in example C. However, the goal of a uniform profit allocation is achieved with the roll forward as presented in example C.1.

Example C.2:

In the following example we will present how to proceed when the CSM turns negative:

- For the contract in example C the inflows are -€800 and received at initial recognition.
- At initial recognition the assumptions result in a CSM of €80:
  \[€80 = €800 \text{ (inflows)} - €600 \text{ (outflows)} - €120 \text{ (acquisition costs)}\]

<table>
<thead>
<tr>
<th>CSM roll forward in C</th>
<th>CSM</th>
<th>Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>01/01/x</td>
<td>80</td>
<td></td>
</tr>
<tr>
<td>31/03/x Release of CSM</td>
<td></td>
<td>-20</td>
</tr>
<tr>
<td>31/03/x</td>
<td>60</td>
<td></td>
</tr>
<tr>
<td>30/06/x Expected outflows related to future service (30/06/x) as at 30/03/x</td>
<td></td>
<td>300</td>
</tr>
<tr>
<td>30/06/x Expected outflows related to future service (30/06/x) as at 30/06/x</td>
<td></td>
<td>480</td>
</tr>
<tr>
<td>30/06/x Change in estimate set off against CSM</td>
<td></td>
<td>-60</td>
</tr>
<tr>
<td>30/06/x</td>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>

CSM at GIC level:

In practice a portfolio will consist of several contracts with different durations. The durations have to be considered when estimating the coverage units for the allocation/release of the CSM.

Example C.3:

- The CSM is €240 as at 31/03/x.
- 10% of the contracts (based on total premium, sum assured, total coverage or further adequate volume measures) expire as at 30/06/x.
- 40% of the contracts expire as at 30/09/x.
- The remaining contracts expire as at 31/12/x.

Assuming there is no change in estimates the CSM is released with the following amounts at the following 3 valuation dates:

- 30/06/x: €100 (= 240*1*(1/(1+0.9+0.5)))
- 30/09/x: €90 (= 140*0.9*(1/(0.9+0.5))),
- 31/12/x: €50 (= 50*0.5*(1/(0.5)).

**Example D:**
- For the contract in example B it is assumed that there is a portfolio entry in third quarter of a contract with coverage period from 01/07/x to 31/12/x.
- There are no acquisition costs related to the contract.
- Premium of €300 is paid at inception.
- Claim estimate is €200 which incurs and is settled in quarter 4.

<table>
<thead>
<tr>
<th>CSM roll forward in C</th>
<th>CSM</th>
<th>Changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>01/01/x</td>
<td>480</td>
<td></td>
</tr>
<tr>
<td>31/03/x</td>
<td></td>
<td>-120</td>
</tr>
<tr>
<td>31/03/x</td>
<td>360</td>
<td></td>
</tr>
<tr>
<td>30/06/x</td>
<td></td>
<td>-120</td>
</tr>
<tr>
<td>30/06/x</td>
<td>240</td>
<td></td>
</tr>
<tr>
<td>30/09/x</td>
<td></td>
<td>100</td>
</tr>
<tr>
<td>30/09/x</td>
<td></td>
<td>-170</td>
</tr>
<tr>
<td>30/09/x</td>
<td>170</td>
<td></td>
</tr>
</tbody>
</table>

5.3. **Accounting the LRC**

**IFRS 17.BC23:** After initial recognition, IFRS 17 also requires an entity to recognize specified **changes in the contractual service margin** for a group of insurance contracts. These changes depict changes in the future profit to be earned from providing services under the contracts, and include:

(a) **changes in the estimates** of the fulfilment cash flows that relate to future service (see paragraphs BC222–BC269);
(b) the effect of the time value of money on the contractual service margin (see paragraphs BC270–BC276) and, for insurance contracts with direct participation features, changes in the entity’s share of the underlying items (see paragraphs BC238–BC263);
(c) the effect of changes in foreign currency exchange rates on the contractual service margin (see paragraphs BC277–BC278); and
(d) the profit earned in the period from providing services (see paragraphs BC279–BC283).

In example C the LRC as at 31/03/x and 30/06/x is calculated as follows:

<table>
<thead>
<tr>
<th>LRC calculation (in €)</th>
<th>31/03</th>
<th>30/06</th>
</tr>
</thead>
<tbody>
<tr>
<td>LRC – Inflows</td>
<td>-200</td>
<td>-200</td>
</tr>
<tr>
<td>LRC – Outflows related to future services</td>
<td>450</td>
<td>480</td>
</tr>
</tbody>
</table>
### LRC movement 31/03 to 30/06 (in €)

<table>
<thead>
<tr>
<th>LRC</th>
<th>Recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/03 LRC (start amount)</td>
<td>610</td>
</tr>
<tr>
<td>30/06 Release of expected cash flows: Payment (with recognition in P&amp;L offset by actually incurred expenses)</td>
<td>-50, Payment</td>
</tr>
<tr>
<td>30/06 Release of expected cash flows: Transfer to LIC (with recognition in P&amp;L offset by recognition of expenses for LIC)</td>
<td>-100, LIC</td>
</tr>
<tr>
<td>30/06 Change in estimate</td>
<td>180, CSM</td>
</tr>
<tr>
<td>30/06 Change in estimate (recognition in CSM)</td>
<td>-180, LRC</td>
</tr>
<tr>
<td>30/06 Release of CSM</td>
<td>-60, P&amp;L</td>
</tr>
<tr>
<td>30/06 LRC (end amount)</td>
<td>400</td>
</tr>
</tbody>
</table>

The unexpected additional effort of €90 for claims in the second quarter is recognized as experience adjustment directly in P&L. The second quarter closes with a loss of -€30=€60 (release of CSM) – €90 (experience adjustment).

In **example C.2** a loss component of the LRC has to be established.

### LRC calculation (in €)

<table>
<thead>
<tr>
<th>LRC calculation (in €)</th>
<th>31/03</th>
<th>30/06</th>
</tr>
</thead>
<tbody>
<tr>
<td>LRC – Inflows</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>LRC – Outflows related to future service w/o loss component (LC)</td>
<td>450</td>
<td>360</td>
</tr>
<tr>
<td>Outflows related to future service – loss component</td>
<td></td>
<td>120</td>
</tr>
<tr>
<td>CSM</td>
<td>60</td>
<td>0</td>
</tr>
<tr>
<td>LRC (total)</td>
<td>510</td>
<td>480</td>
</tr>
</tbody>
</table>

### LRC movement 31/03 to 30/06 (in €)

<table>
<thead>
<tr>
<th>LRC</th>
<th>Recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td>31/03 LRC (start amount)</td>
<td>510</td>
</tr>
<tr>
<td>30/06 Payment (w/o recognition in P&amp;L)</td>
<td>-50, Payment</td>
</tr>
<tr>
<td>30/06 Transfer to LIC (w/o recognition in P&amp;L)</td>
<td>-100, LIC</td>
</tr>
<tr>
<td>30/06 Change in outflows related to future service</td>
<td>60, LRC</td>
</tr>
<tr>
<td>30/06 Change in outflows related to future service</td>
<td>120, Loss Component</td>
</tr>
<tr>
<td>30/06 Change in outflows related to future service</td>
<td>-60, LRC</td>
</tr>
<tr>
<td>30/06 Release of CSM</td>
<td>0, P&amp;L</td>
</tr>
<tr>
<td>30/06 LRC (end amount)</td>
<td>480</td>
</tr>
</tbody>
</table>
Here the second quarter closes with a loss of -€210 = -€90 (experience adjustment) - €120 (change in estimate that cannot be offset in CSM).

In case of another change in estimate in quarter 4 with a positive adjustment of CSM due to a positive claim experience the outflows will be reduced for a maximal amount of €120, which is presented as a profit (IFRS 17.50).

5.4. Identification of onerous contracts (OCT)

The expected loss and expenses can usually only be determined with sufficient accuracy for a whole portfolio of insurance contracts. A management pricing strategy is usually based on this expected loss and expenses and a profit expectation. For the identification of onerous contracts and the grouping by profit expectation according to the standard, therefore, the allocation method used to determine the loss and expense cash flows for subsets of contracts or individual contracts is essential. To make the pricing strategy of the entity transparent to investors, the choice of the allocation method should be based on the management's view of pricing the products. A further allocation of expected loss and expenses to subsets of the portfolio in the context of an actuarial tariff calculation usually serves the purpose of establishing the view of the management of the uniform profitability in relation to the premiums by determining suitable rating factors. In order to ensure the controllability of the complexity of the model and to make the management’s view of pricing transparent, classification criteria will usually not be used in the allocation of the loss and expense cash flows in the valuation model for IFRS 17. Exceptions may be explicit decisions of the management to set by the means of rating factors a significantly different profit expectation in relation to the premium for certain subgroups than for the entire portfolio.

Once the valuation model has been determined, the measurement of sets of contracts will basically take place within the framework of the chosen model. It is no objective of the processes of OCT and profit group building to constantly question the model itself, but to set suitable model parameters for subgroups. In the context of the general measurement model, any reasonable and supportable information from the internal reporting has to be used. For a property and casualty insurer, there are generally scores of models and evaluations for estimating the profitability of products, customers, portfolios of contracts and agents. With fairly regularity, however, these will not or only partially meet the requirements for measurement in compliance with IFRS 17. Reports based on these models and evaluations will only be considered reasonable and supportable information linked to the OCT and grouping by profitability in accordance with the standard if a transformation in parameters of the entity’s IFRS 17 valuation model is possible without undue cost or effort.
Example:

In the valuation model of the company, premium cash flows are determined according to the agreed amount and due date. Claims payment cash flows are derived from premium cash flow based on portfolio-dependent rates and separately for attritional, large and cumulative losses. Expense cash flows are also derived from premium cash flow based on portfolio-based ratios.

- An IFRS 17 portfolio may consist of two lines of business according to German GAAP segmentation. Profit in terms of German GAAP was clearly positive for one line of business in the last three years and clearly negative for the other one. If there was a direct link from the German combined ratio to the parametrization of the IFRS 17 valuation model at portfolio level, it is quite obvious that the result of valuation the two lines of business with model parameters adjusted accordingly would be that they belong to different profitability groups. If the IFRS 17 valuation model was based on actuarially calculated parameters and a complex modeling approach, this conclusion would not be self-evident. Only if a reasonable and supportable quantification of the impact on the loss and/or expense ratios used was possible without undue cost or effort, an OCT would be carried out with the quantities adjusted accordingly.

- Agents have a budget at their own discretion to give discounts on premiums. The maximum discount is 50%, the average 10%. The budget is defined in relative terms as 10% of the undiscounted premium of the contracts sold by the agent. The combined ratio in terms of the entity’s IFRS 17 valuation model is 90%. The ratios used as parameters in the model are calculated by the assumption of an average discount of 10%. Without further information, no Onerous Contract Test for highly discounted contracts would be triggered, as on the one hand the discounting may be considered as the result of an individual risk assessment by the agent and therefore the necessity of an adjustment of the loss or expense ratios is not obvious. On the other hand because of the limited budget, a high discount on a contract is only possible if at the same time a low or no discount is granted on other contracts. The allocation of loss and expenses on the basis of premiums net of discount thus reflects the intention of using this discount mechanism as a part of the management’s pricing strategy.

- The motor liability portfolio consists of several tariffs. The characteristic "Garage exists" results in a discount of 3% or 5% for some of the tariffs, for others it is no rating factor. The combined ratio used in the model is 97%. As a result of an actuarial calculation the new tariff provides for a discount of 10% if there is a garage. This information alone does not trigger an Onerous Contract Test. It is completely unclear whether and to what extent the loss/expense ratios used in the model need to be adjusted to reflect this fact. Classification models are usually multivariate. A different rate factor for the same characteristic in comparison with previous actuarial calculation
may be due to the addition or removal of other characteristics or to a variety of other changes and is not reasonable and supportable information that could be used without undue cost or effort to adjust the model parameters appropriately.

- Special evaluations from the controlling department show a correlation between the age of the insured buildings and the expected losses in homeowners' insurance. Residential buildings built prior to a certain date are loss-making. As the portfolio “homeowners’ insurance” in actuarial modelling - as usual - is not subdivided by building age, the findings from controlling do not trigger an onerous-contract test. The classification of a new underwriting year cohort as onerous or not is made without further internal differentiation; it only depends on the measured and planned combined ratios of the entire portfolio.
6. Liability for Incurred Claim (LIC)

**IFRS 17.40:** The carrying amount of a group of insurance contracts at the end of each reporting period shall be the sum of

(a) the liability for remaining coverage comprising

i. the fulfillment cash flows related to future service allocated to the group at that date, measured applying paragraphs 33-37 and B36-B92.

ii. the contractual service margin of the group at that date, measured applying paragraphs 43-46; and

(b) the **liability for incurred claims**, comprising the fulfillment cash flows related to past service allocated to the group at that date, measured applying paragraphs 33-37 and B36-B92.

For LIC the BBA approach is applied as well consisting of discounted future best estimate cash flows and risk adjustment for non-financial risk. However, there is no contractual service margin set up in the LIC (IFRS 17.40(b)).

6.1. Differences to IFRS 4 – US-GAAP or HGB

The liability for incurred claims is set up for (unknown and known) claims resulting from insured events that have already occurred, but which are not fully settled yet (IFRS 17 Appendix A).

The DAV Committee report „Best Estimates in der Schaden-/Unfallversicherung“ concludes that although the Solvency II and US-GAAP requirements on estimation methods differ, they result in the same undiscounted liability for past claims. Consequently, the report assumes a uniquely defined best estimate liability.

The following table summarizes the differences and similarities between Solvency II, US-GAAP, IFRS 17 and, for completeness, HGB (German GAAP).

<table>
<thead>
<tr>
<th>Solvency II</th>
<th>IFRS 17</th>
<th>US-GAAP</th>
<th>HGB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Undiscounted liabilities for past claims</td>
<td>Best Estimate (Claims Provision) Calculation based on current and credible information as well as realistic assumptions and adequate, applicable and relevant actuarial and statistical methods.</td>
<td>Best Estimate Calculation based on current and credible information as well as realistic assumptions and adequate, applicable and relevant actuarial and statistical methods.</td>
<td>Best Estimate Calculation based on current and credible information as well as realistic assumptions and adequate, applicable and relevant actuarial and statistical methods.</td>
</tr>
<tr>
<td>Discounting for B/S presentation</td>
<td>Discounting of future cash flows with the relevant discount rate at the valuation date to correct for the time value of money</td>
<td>Discounting of future cash flows with the relevant discount rate at the valuation date to correct for the time value of money</td>
<td>No discounting. Exception: Annuities</td>
</tr>
<tr>
<td>Discounting for P&amp;L</td>
<td>n/a</td>
<td>When applying the PAA for LRC calculation of the interest expense based on the discount rate as applicable at claim occurrence.</td>
<td>No discounting. Exception: Annuities</td>
</tr>
<tr>
<td>Risk Margin</td>
<td>Explicit calculation, one year view</td>
<td>Explicit calculation, no view specified</td>
<td>n/a</td>
</tr>
</tbody>
</table>

**Table 3** Comparison of LIC under Solvency II, IFRS 17, US-GAAP and HGB (German GAAP)
In the following section details to the components as in the table above will be provided.

6.2. *Estimate of future cash flows (expected value of undiscounted best estimate cash flows)*

**IFRS 17.33:** An entity shall include the measurement of a group of insurance contracts all the future cash flows within the boundary of each contract in the group (see paragraph 34). Applying paragraph 24, an entity may estimate the future cash flows at a **higher level of aggregation and then allocate the resulting fulfilment cash flows to individual groups of contract**. The estimates of future cash flows shall:

(a) incorporate, in an unbiased way, all reasonable and supportable information available without undue cost or effort about the amount, timing and uncertainty of those future cash flows (see paragraphs B37-B41). To do this, an entity shall estimate the expected value (i.e. the probability-weighted mean) of the full range of possible outcomes.

(b) reflect the perspective of the entity, provided that the estimates of any relevant market variables are consistent with observable market prices for those variables (see paragraphs B42-B53).

(c) be current - the estimates shall reflect conditions existing at the measurement date, including assumptions at that date about the future (see paragraphs B54-B60)

(d) be explicit - the entity shall estimate the adjustment for non-financial risk separately from the other estimates (see paragraph B90). The entity also shall estimate the cash flows separately form the adjustment for the time value of money and financial risk, unless the most appropriate measurement technique combines these estimates (see paragraph B46).

The best estimate cash flows under IFRS 17 should include cash flows that are related to fulfill the obligation of the insurance contract. The undiscounted LIC liabilities under IFRS 17 HGB/German GAAP results in a different amount, in particular due to the applicable prudent principle.

**Structure of the claim triangles**
The choice of the valuation approach has implication, when applying the **OCI option**, on the granularity of the LIC.

- When applying the BBA approach the part of unwind of discount (insurance finance expense) presented in the P&L is calculated based on the interest as at **initial recognition of the GIC**. This means, the LIC cash flows must be
available in the according granularity, i.e. per GIC. The claim triangles applied today, in particular in primary insurance, are often based on claim occurrence/accident date (IFRS 17.B72(3)(ii)).

For a book of contracts with different durations attention must be paid to the homogeneity of the data (e.g. in case of durations of one year and five years the claim triangle would include in column five entries for development year one and five). A change of the composition of the book in terms of durations or the lapse behavior would yield to distortions in the claim triangle. A homogenization of the book results, in particular for small books, to a depletion of the claim triangles and a higher volatility. An option would be to use a simple allocation approach to allocate accident based cash flows to recognition dates. Based on the company individual books it must be investigated, if this is possible and how stable it is.

- When applying the PAA approach the release of cash flows from the LIC is calculated based on accident based data. Correspondingly, the cash flows must be available in the according granularity. This could yield to increased effort for undertakings where the data basis is available based on inception/underwriting date.

When not applying the OCI option, the impacts from the current change in interest rate are presented in P&L. However, the requirements to derive estimates of future cash flows are without pre-defined granularity as long as it can be assumed that the sum of LRC and LIC of each GIC are in a liability position. In this case the structure of the claim triangles is of subordinated significance. However, not using the OCI option yields to an increased volatility of results.
**6.3. Discounting**

| **IFRS 17.36:** | An entity shall adjust the estimates of future cash flows to reflect the time value of money and the financial risk related to those cash flows, to the extent that the financial risks are not included in the estimates of cash flows. The **discount rates applied** to the estimates of the future cash flows described in paragraph 33 shall:
| (a) reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts;  
(b) be consistent with observable current market prices (if any) for financial instruments with cash flows whose characteristic are consistent with those of the insurance contracts, in terms of, for example timing, currency and liquidity; and  
(c) exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts. |
| **IFRS 17.88:** | Unless paragraph 89 applies, an entity shall make an accounting policy choice between:  
(a) including insurance finance income or expenses for the period in **profit or loss;** or  
(b) disaggregating insurance finance income or expenses for the period to include in profit or loss an amount determined by a **systematic allocation** of the expected total insurance finance income or expenses over the duration of the group of contracts, applying paragraphs B130-B133. |

No discounting is applied in HGB and US-GAAP (besides for annuities) whereas in Solvency II and IFRS 17 an adjustment of the future cash flows for the time value of money is explicitly required, and for any inherent financial risk. Under Solvency II the discount rate for the insurance liabilities is defined by EIOPA whereas IFRS 17 follows a principle based approach (IFRS 17.36). Consequently, the discount rates can be different among reporting entities.

When applying the OCI option under IFRS 17 for calculating interest expense the historical interest rate curves must be provided to calculate the part of unwinding of interest to be presented in P&L for the period. The discounted liabilities must be calculated using the **lock-in interest rate** (IFRS 17.B72) and the current interest rate at the valuation date and the valuation difference is booked into OCI. The mechanism is illustrated in the following:
6.4. **Risk Adjustment**

**IFRS 17.37:** An entity shall adjust the estimate of the present value of the future cash flows to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.

With the prudence principle an implicit risk adjustment is applied under HGB. There is no explicit risk adjustment in US-GAAP. In Solvency II and IFRS 17 an explicit risk margin/risk adjustment is recognized. The methodology choice as well as the parameter setting can yield to different results (IFRS 17.B91).

6.5. **Example**

**Example E:**

We continue the example B from above.

- Contractual term: 01/01/x to 31/12/x.
- It is assumed that all claims of the contract are settled within two quarters. The claim amount per accident quarter is €150. We assume the claim occurs at 28/02/x.
- One third of the claim payments are attributable to the accident quarter (paid out at once), two third are attributable to the following quarter (paid out at the end).
- The total premium amount is €1,200, where €200 is expected as adjustment premium.
- Risk adjustment is neglected.
• Valuation date is 31/03/x.

• We assume an interest rate of 1% at contract recognition date, 2% at claim occurrence date (28/02), 3% at 31/03/x.

We have the following cash flows as at 31/03/x where we assume that the claim occurred at 28/02/x.

<table>
<thead>
<tr>
<th>LIC calculation (in €)</th>
<th>Total</th>
<th>Thereof: due in quarter 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>LIC Outflows</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>LIC – Discounted</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(as at 28/02/x)</td>
<td>99.34</td>
<td></td>
</tr>
<tr>
<td></td>
<td>[100*(1+2%)^(-1/3)]</td>
<td></td>
</tr>
<tr>
<td>LIC – Discounted</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(as at 31/03/x)</td>
<td>99.26</td>
<td></td>
</tr>
<tr>
<td></td>
<td>[100*(1+3%)^(-1/4)]</td>
<td></td>
</tr>
</tbody>
</table>

The recognition of the interest rate impact depends on the approach applied for LRC.

<table>
<thead>
<tr>
<th>LRC calculation as at 31/03/x (in €)</th>
<th>LIC (31/03)</th>
<th>LIC (locked in)</th>
<th>OCI Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>BBA applied to LRC</td>
<td>99.26</td>
<td>99.75</td>
<td>0.48</td>
</tr>
<tr>
<td>PAA applied to LRC</td>
<td>99.51</td>
<td>99.51</td>
<td>0.24</td>
</tr>
</tbody>
</table>
7. Presentation & Disclosures

7.1. Balance sheet presentation

<table>
<thead>
<tr>
<th>IFRS 4*</th>
<th>IFRS 17</th>
<th>Key changes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Reinsurance contract assets</td>
<td>Reinsurance contract assets</td>
<td>Groups of insurance (or reinsurance) contracts that are in an asset position presented separately from groups of insurance (or reinsurance) contracts that are in a liability position</td>
</tr>
<tr>
<td>Deferred acquisition costs</td>
<td>Insurance contract assets</td>
<td>Other assets and other liabilities included in the measurement of insurance contracts issued and reinsurance contracts held resulting in an overall simplified presentation on the balance sheet</td>
</tr>
<tr>
<td>Value of business acquired</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Premiums receivable</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Policy loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance contracts liabilities</td>
<td>Insurance contracts liabilities</td>
<td></td>
</tr>
<tr>
<td>Unearned premiums</td>
<td>Reinsurance contracts liabilities</td>
<td></td>
</tr>
<tr>
<td>Claims payable</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

7.2. P&L presentation

According to IFRS 17.80 the amounts presented in the P&L shall be disaggregated into insurance service result comprising of insurance revenue and insurance service expenses and insurance finance income or expenses. In the following we will detail the presentation for each of the components.

**Insurance Revenue**

In contrast to today the insurance revenue is not calculated based on premiums, but on the expected release of LRC for the period.

**Investment Component**

**IFRS 17.B120:** The total insurance revenue for a group of insurance contracts is the consideration of the contracts, i.e. the amount of premiums paid to the entity:
(a) adjusted for a financing effect; and
(b) excluding any investment components.

**IFRS 17.84:** An entity shall present in profit or loss insurance service expenses arising from a group of insurance contracts issued, comprising incurred claims (excluding repayments of investment components), other incurred insurance service expenses and other amounts as described in paragraph 103(b).
A special feature under IFRS is the so called **investment component** that must be deducted from revenue and claim expenses. An investment component is the amount that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur (IFRS 17 Appendix A).

Investment components are preeminently included in life insurance contracts, but can also be relevant for non-life insurance contracts:

- Non-performance related premium refund („erfolgsunabhängige Beitragsrückerstattung“)
- Profit commission

**Insurance finance income or expenses**

**IFRS 17.87:** **Insurance finance income or expenses** comprises the change in the carrying amount of the group of insurance contracts arising from:

(a) the effect of the time value of money and changes in the time value of money; and
(b) the effect of financial risk and changes in financial risk; but
(c) excluding any such changes for groups of insurance contracts with direct participation features that would adjust the contractual service margin but do not do so when applying paragraphs 45(b)(ii), 45(b)(iii), 45(c)(ii) or 45(c)(iii). These are included in insurance service expenses.

**IFRS 17.88:** Unless paragraph 89 applies, an entity shall make an accounting policy choice between:

(a) including insurance finance income or expenses for the period in profit or loss; or
(b) disaggregating insurance finance income or expenses for the period to include in profit or loss an amount determined by a **systematic allocation** of the expected total insurance finance income or expense over the duration of the group of contracts applying paragraphs B130-B133.

**7.3. Disclosure**

**IFRS 17.87:** The objective of the **disclosure requirements** is for an entity to disclose information in the notes that, together with the information provided in the statement of financial position, statement(s) of financial performance and statement of cash flow, gives a basis for users of financial statements to assess the effect that contracts within the scope of the IFRS 17 have on the entity’s financial position, financial performance and cash flows. To achieve that objective, an entity shall disclose qualitative and quantitative information about:

(a) the amounts recognized in its financial statements for contracts within the scope of IFRS 17 (see paragraphs 97-116);
(b) the significant judgements, and changes in those judgements made when applying IFRS 17 (see paragraphs 117-120); and
(c) the nature and extent of the risks form contracts within the scope of IFRS 17 (see paragraphs 121-132).
8. Transition

**IFRS 17.C1:** An entity shall apply IFRS 17 for annual reporting periods beginning on or after 1 January 2021. [...]  
**IFRS 17.C2:** For the purposes of the transition requirements:  
(a) the date of initial application is the beginning of the annual reporting period in which an entity first applies IFRS 17; and  
(b) the transition date is the beginning of the annual reporting period immediately preceding the date of initial application.  
**IFRS 17.C3:** An entity shall apply IFRS 17 **retrospectively** unless impracticable, except that [...]  
**IFRS 17.C4:** To apply IFRS 17 retrospectively, an entity shall at the transition date:  
(a) identify, recognise and measure each group of insurance contracts as if IFRS 17 had always applied;  
(b) derecognise any existing balances that would not exist had IFRS 17 always applied; and  
(c) recognise any resulting net difference in equity.  
**IFRS 17.C4:** If, and only if, it is impracticable for an entity to apply paragraph C3 for a group of insurance contracts, an entity shall apply the following approaches instead of applying paragraph C4(a):  
(a) the **modified retrospective approach** in paragraphs C6–C19, subject to paragraph C6(a); or  
(b) the **fair value approach** in paragraphs C20–C24.

For general interpretation of the requirements regarding transition, we refer to the DAV document on IFRS 17 Transition. In this chapter, only some specialties for the P&C business should be mentioned.

There will be group of contracts where the full retrospective approach will be impractical. For these contracts, the application of the modified retrospective or fair value approach may be necessary (e.g. for contracts with long coverage or long settlement period), given the difficulties that may occur in retrieving all necessary historical data, especially regarding the locked-in discount rate at inception or claim incurrence.

Due to the fact, that the impracticability of the full retrospective approach can be only found out on an individual entity level, the focus of the following passage is on the full retrospective approach.
8.1. Liability for Remaining Coverage (PAA)

For non-onerous group of contracts the PAA measurement is applied to, an entity needs to retrospectively calculate the LRC, by using mainly information regarding received premiums and acquisition expenses, which should be historically available. If those contracts have a significant financing component, the discount rate at initial recognition would be necessary as well. In this case, depending on the contract duration, the effort for the derivation of those discount rates might vary. The derivation of the discount rate in context of IFRS 17 is presented in detail in the DAV document on IFRS 17 interest rate.

The loss component is the difference between the carrying amount of the liability for remaining coverage determined by the PAA and the fulfilment cash flows that relate to remaining coverage of the group determined by the BBA. Therefore, for group of contracts that were onerous at inception, additionally some data requirements for the BBA-LRC would be necessary.

8.2. Liability for Remaining Coverage (BBA)

The determination of the LRC amounts measured by the Building Block approach might be more difficult compared to the PAA; especially the calculation of the CSM at the day of transition might be the main complexity driver for the full retrospective approach.

For the determination of the liability for remaining coverage at transition date, the following amounts are required for each group of contract:

- discounted future cash flows,
- risk adjustment;
- CSM or loss component;
- the locked-in discount rate at inception, being the discount rate used for CSM accretion,
- the accumulated OCI (if the OCI option is elected) and
- the unamortised part of acquisition costs for future amortization.

The CSM or loss component, the locked-in discount rate and the accumulated OCI all require information from the date of initial recognition, which may be many years before the date of transition. Depending on the contract duration, the effort for the derivation of the discount rate at initial recognition might vary.

Even if the majority of German P&C products has only a short coverage period, some insurer will have contracts in force at transition, which were recognized much prior to transition. Due to data limitations, the mentioned simplifications (IFRS17.C5) can be used then.
8.3. Liability for Incurred Claims

For a group of contracts being in the run-off, that means that there is no liability for remaining coverage anymore, only the fulfillment cash flows for the liability for incurred claims need to be estimated at transition. In general, the estimation of the liability for incurred claims for this group of contracts could be calculated prospectively, taking into account discounted future (claim) cash flows and the corresponding risk adjustment.

But if the usage of the OCI-option is chosen, i.e. the entity chooses to disaggregate insurance finance income or expenses between amounts included in profit or loss and amounts included in other comprehensive income, (IFRS17.88), the OCI-amount at transition needs to be calculated. Therefore, the locked-in discount rates are necessary for the calculation of those LIC-amounts. Depending on the applied approach, this is the locked-in rate at initial recognition for the BBA and the locked-in rate at claim incurrence for the PAA. The OCI-amount is than calculated as the difference between the present value of future cash flows using the lock-in discount rate and the present value of future cash flows using the discount rate at transition.

Having in mind some liability business, where claims are still open and developing after 25 years, the expected future cash flows would be estimated with common approaches, which would be more or less easy from an actuarial perspective. However, the derivation of the necessary discount rates, which were valid at least 25 years ago, could lead than to bigger issues.
## Glossary

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>BBA</td>
<td>Building Block Approach</td>
</tr>
<tr>
<td>BC</td>
<td>Basis for Conclusion</td>
</tr>
<tr>
<td>CSM</td>
<td>Contractual Service Margin</td>
</tr>
<tr>
<td>FCF</td>
<td>Fulfillment Cash Flows</td>
</tr>
<tr>
<td>GIC</td>
<td>Groups of Insurance Contracts</td>
</tr>
<tr>
<td>HGB</td>
<td>Handelsgesetzbuch (German GAAP)</td>
</tr>
<tr>
<td>IBNR</td>
<td>Incurred, but not Reported</td>
</tr>
<tr>
<td>LIC</td>
<td>Liability for Incurred Claims</td>
</tr>
<tr>
<td>LRC</td>
<td>Liability for Remaining Coverage</td>
</tr>
<tr>
<td>OCI</td>
<td>Other Comprehensive Income</td>
</tr>
<tr>
<td>OCT</td>
<td>Onerous Contract Test</td>
</tr>
<tr>
<td>P&amp;L</td>
<td>Profit and Loss</td>
</tr>
<tr>
<td>PAA</td>
<td>Premium Allocation Approach</td>
</tr>
<tr>
<td>PIC</td>
<td>Portfolio of Insurance Contracts</td>
</tr>
<tr>
<td>RA</td>
<td>Risk Adjustment</td>
</tr>
<tr>
<td>VFA</td>
<td>Variable Fee Approach</td>
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