New International Financial Reporting Standard for Insurance Contracts–IFRS 17

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Abstract: *The International Accounting Standards Board (IASB) published on 18 May 2017 the International Financial Reporting Standard (hereinafter "IFRS") 17 "Insurance contracts". It has been 20 years since the IASB (International Accounting Standards Committee) initiated the entire project for accounting and reporting of insurance contracts. The new standard for the accounting period beginning on or later than 1 January 2021 replacing IFRS 4 "Insurance contracts" is a significant milestone for the entire insurance market as it becomes the first, global, standard for insurance contracts. Early application of the Standard is permitted provided that IFRS 9 "Financial Instruments" and IFRS 15 "Reporting Revenues from Customer Treaties" are also applied. IFRS 17 represents a significant change compared to a current accounting policies for insurance companies in many countries because it fundamentally changes the content and manner of presentation of information that insurance companies provide to shareholders, clients and other entities.*

Keywords: *IFRS 17, IFRS 4, Solvency II, Insurance contracts*

JEL codes: G15, G22, G28

1 Introduction

IFRS 17 standard applies to all insurance and reinsurance contracts (short-term and long-term) as well as to investment contracts with elements of voluntary participation. IFRS 17 will have a major impact on the reporting of insurance companies, either directly in their annual reports or through their European parent companies. The step from IFRS 4 to IFRS 17 should not be underestimated. While IFRS 4 allows insurance companies to maintain current accounting policies based on their accounting standards, IFRS 17 requires extensive changes in accounting, valuation, presentation and disclosure of informations about life and non-life insurance and reinsurance contracts. (Gascoigne, 2017).

The goal of IFRS 17 is to improve financial reporting by providing more transparent and comparable information on:

- Impact of insurance contracts on financial performance,
- the way in which insurance companies earn profits or make losses, by subscribing to insurance premiums form clients,
- the nature and extent of the risks to which insurers are exposed as a result of the issue of insurance contracts.

Table 1 Comparison of IFRS 4 and IFRS 17

IFRS 4*	IFRS 17
Premiums	Insurance revenue
Investment income	Incurred claims and expenses
Incurred claims and expenses	Insurance service result
Change in insurance contract liabilities	Investment income
Profit or loss	Insurance finance expense
(*) Common presentation in the statement of comprehensive of comprehensive income in applying IFRS 4.	Net financial result
	Profit or loss
	Discount rate changes on insurance liability (optional)
	Total comprehensive income

Note: Grey shading marks line items on the balance sheet.
Source: Barella, L., Boreman, A. (2017).
General insurance: The wide-ranging implications of IFRS 17.

According to IFRS 17 standard, the insurance contract (reinsurance) liabilities are calculated as the sum of:

- payment flows, which are defined as the present value of future cash flows plus explicit risk adjustment for insurance risk,
- Contractual service margin (expected profit from unrealized part of the contract).

Discount rates will be reflecting current interest rates. IASB Chairman Hans Hoogervosrst considers using of the current discount rate as one of the benefits of IFRS 17 standard. Current discount rates would increase comparability between insurance companies and other institutions operating in the financial market (Hoogervosrst, 2017).

Insurance companies will be able to set discount rates in two ways:

- From top to down, starting with the current or expected portfolio reference rate,
- From bottom to up, starting with the risk-free rate of return.

IFRS 17 will provide insurers with the ability to decide whether volatility will be recognized in either the income statement or other comprehensive income due to changes in discount rates.

The IFRS 17 liability measurement model is also known as the building block approach ("BBA" in short). Insurers will be also able to use the model of simplification, so called access to premium allocation ("PAA" in short). This simplification is only allowed under certain circumstances and applies only to non-expedited risks, the contingent liability obligations must continue to be governed by the BBA model. According to the PAA approach, the contractual service margin is not required. This approach is permitted in the case of insurance contracts for which the commitment term is for a maximum of one year and its valuation is not substantially different from the BBA valuation. IFRS 17 states that the second requirement is not met if, from the outset, a significant variability in cash flow performance is expected that affects the measurement of the liability for the remaining cover during the period preceding the entitlement. In addition, the variability in cash flows increases with the duration of the contract coverage.

2 Methodology and Data

On 18 May 2017, the IASB finished its long-term project to create an accounting standard for insurance contracts resulting in IFRS 17 Insurance Contracts. IFRS 17 becomes effective from January 1, 2021 and replaces IFRS 4 Insurance Contracts, which allows insurance companies to continue their current multiple policies in the reporting of insurance

contracts, leading ultimately to the lack of comparability and transparency of information for analysts and users of financial information.

We have all the information we have used in the article from available book publications and online resources. For more information, see Literary Resources and Other Links.

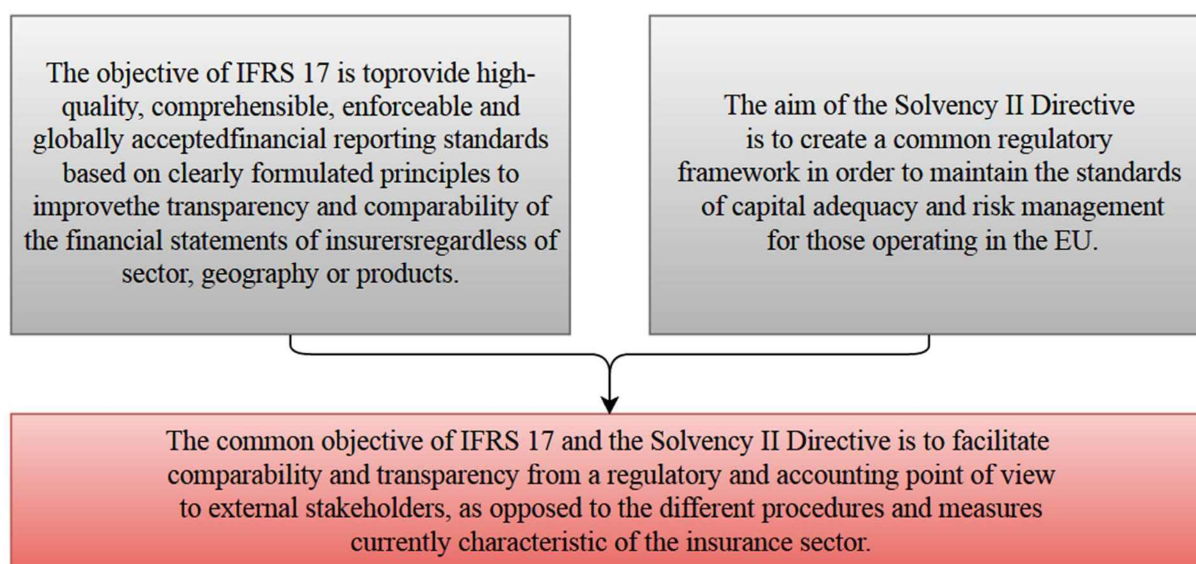
In order to be able to process a quality article, we had to apply a few methods and procedures to it, for example a selection method that focuses on the purposeful and systematic gathering of information and knowledge from available sources. By the method of analysis, we examined the new standard for insurance contracts - IFRS 17. Based on the synthesis method, the acquired knowledge was combined into a single entity. Using the concretization method and the methods of comparison, we presented a comparison of IFRS 17 with IFRS 4 and IFRS 17 with the Solvency II Directive.

IFRS 17 represents a significant milestone for the insurance market as it becomes the first, global, standard for insurance contracts.

3 Results and Discussion

In addition to the IFRS 17 standard, which will become effective for insurance companies for up to four years, the Solvency II Directive, which significantly changed the activity of insurance companies, came into force on 1 January 2016.

Scheme 1 The objectives of IFRS 17 and Solvency II and their common objective



Source: Hein, T. (2017). IFRS 17 and Solvency II.
Insurance regulation meets insurance accounting standards.

There are differences between the IFRS 17 and the Solvency II Directives, which are listed in the table below.

IFRS 17 leaves a number of key areas open for interpretation, thus offering insurers the opportunity to decide. These areas include for example:

- the eligibility to use the PAA simplification option,
- granularity level for measuring and recognizing disadvantageous contracts,
- Accounting principles for determining and reporting risk adjustments,
- selecting a discount rate,
- additional complexity regarding the chargeback,
- Reporting and publishing information.

On the contrary, this is the case for the Solvency II Directive, which is largely prescribed. Insurance companies will have to make some additional judgments following the implementation of IFRS 17.

Table 2 Comparison of IFRS 17 and Solvency II

TOPIC	IFRS 17	SOLVENCY II
Recognition	Earliest of start of coverage and premium receipt (plus onerous contract test)	Date party to contract
Measurement model	Building Block Approach (BBA), or Premium Allocation Approach (PAA), for eligible contracts	No choice, cashflow approach more closedy aligned to BBA, under IFRS 17
Discount rate	Company-specific, principles-based	Prescribed
Risk allowance	Risk adjustment – no prescribed method	Risk margin – cost of capital approach is prescribed
Contractual service margin	Eliminates day-one gain (measure of unearned profit)	No similar concept, day-one gain taken immediately into own funds
Other comprehensive income (optional)	Isolates the impact of discount rate changes from the rest of the P&L	No similar concept

Source: Barella, L., Boreman, A. (2017).
General insurance: The wide-ranging implications of IFRS 17.

Conclusions

In addition to the Solvency II Directive, which entered into relevance in the European Union on 1 January 2016, an insurance companies is expected to introduce a new regulation, namely IFRS 17, issued by the IASB on 18 May 2017, in a short period. It replaces IFRS 4 and acquires its effectiveness on 1. January 2021. Four years may have seem to be a long period, but analysts have already expressed concerns that this is a true minimum for thorough preparation for the complexity of IFRS 17. The current IFRS 4 standard allows insurance companies to apply insurance policies that are largely driven by Local regulatory requirements. This deficiency has made it more difficult for investors and analysts to understand and compare the results of insurance companies, but also insurance companies in relation to other sectors. It is this idea to create a global standard for insurance contracts resulting in IFRS 17. IFRS 17 introduces a consistent framework for the recognition, measurement, presentation and reporting of insurance contracts that should lead to more transparent and comparable information from insurance companies. IFRS 17 will be a challenge for insurers, as it will significantly affect the duration, amount, volatility of reported earnings, as well as the valuation of insurance liabilities and hence the capital of insurance companies. In addition to this, it will also affect the booking process and financial reporting, actuarial models and IT systems.

Acknowledgments

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