

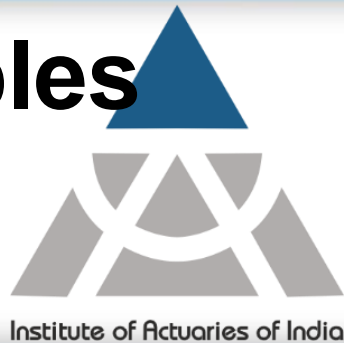
10th Capacity Building Seminar in General Insurance (10th CBGI)

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Ind AS 117 : Understanding with Examples

Suruchi Bhargava

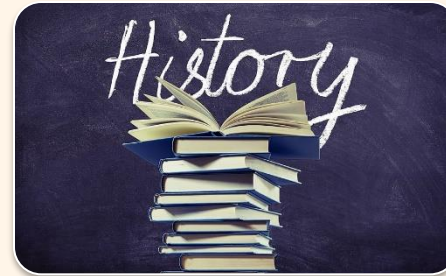
Lead Non-Life Insurance, K.A.Pandit



Session Coverage



Key
Accounting
Policy
Decisions



Liability for
Incurred
Claims
under PAA



Liability for
Remaining
Coverage
under PAA

Accounting Policy Decisions

Accounting Policy Decisions

1. Level of Aggregation

1.1. Onerous Contracts

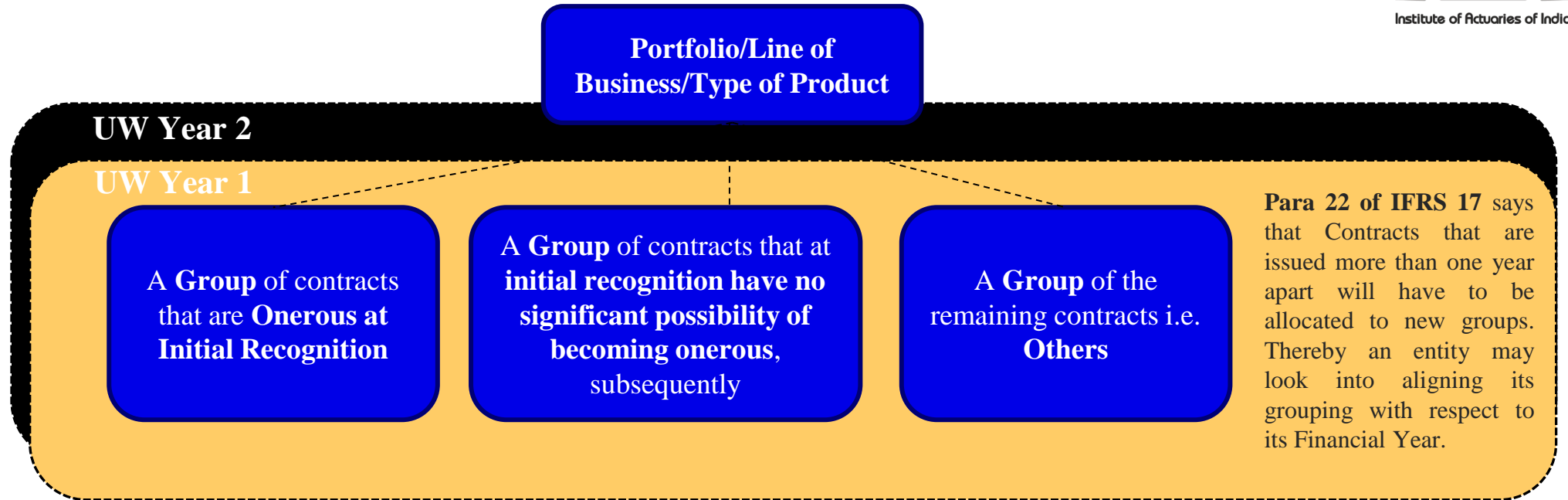
2. Measurement Models

2.1. PAA Eligibility

3. Discount Rate Selection

4. Risk Adjustment Methods

Level of Aggregation/Grouping



- ‘Established at Initial Recognition and not reassessed
- Similar risks and managed together’
- Expected profitability
- Underwriting cohorts

Level of Aggregation: Example

Scenario 1

- An insurance company issues **100** identical contracts
- This entity then expects that..... **5 policyholders will make a claim under the policy**

Scenario 2

- An insurance company issues 500 insurance contracts
- This entity estimates that out of these 500 contracts.....
 - **200 identical contracts are onerous**
 - **The balance 300 identical contracts are profitable and can cover the losses on the 200 onerous ones.**

Level of Aggregation: Solution

Scenario 1

- An insurance company issues **100** identical contracts
- This entity then expects that..... **5 policyholders will make a claim under the policy**

In
this
case

- All the identical contracts form **1** group of insurance contracts
- The entity does not treat those 5 contracts as a separate group

Scenario 2

- An insurance company issues 500 insurance contracts
- This entity estimates that out of these 500 contracts.....
 - **200 identical contracts are onerous**
 - **The balance 300 identical contracts are profitable and can cover the losses on the 200 onerous ones.**

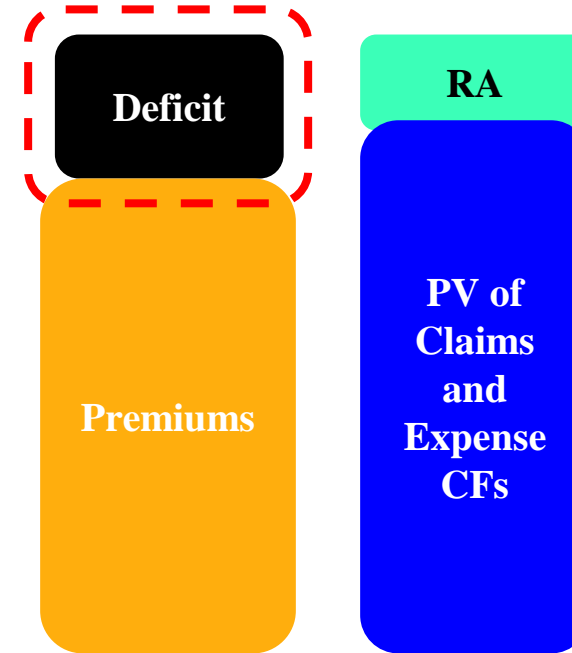
In
this
case

- **2** groups will be made
 - **1 – Onerous Contracts**
 - **2 – Profitmaking Contracts**

Onerous Contracts

Group of contracts which are either:

- Loss making at initial recognition: Full deficit recognized as loss immediately.
- Become Loss making during the lifetime of the contract (i.e. subsequent measurement)

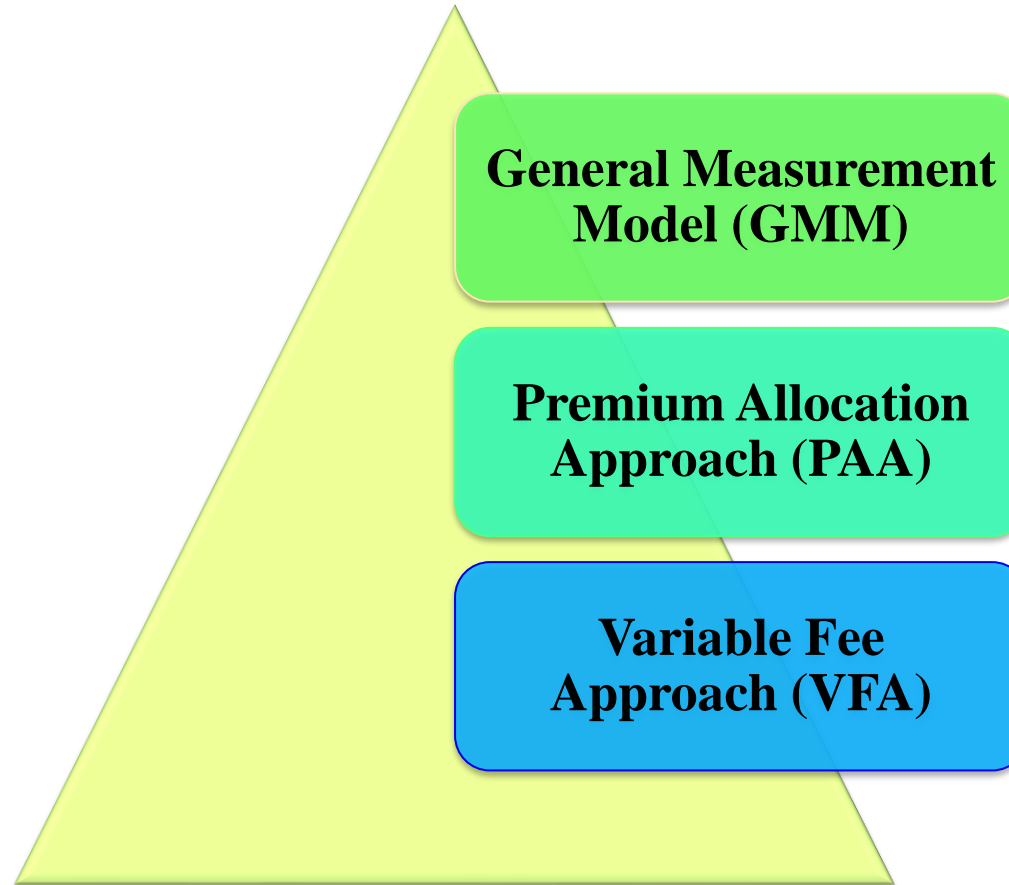


Contract is Onerous if FCF at initial recognition is net outflow i.e. FCF at initial recognition > 0

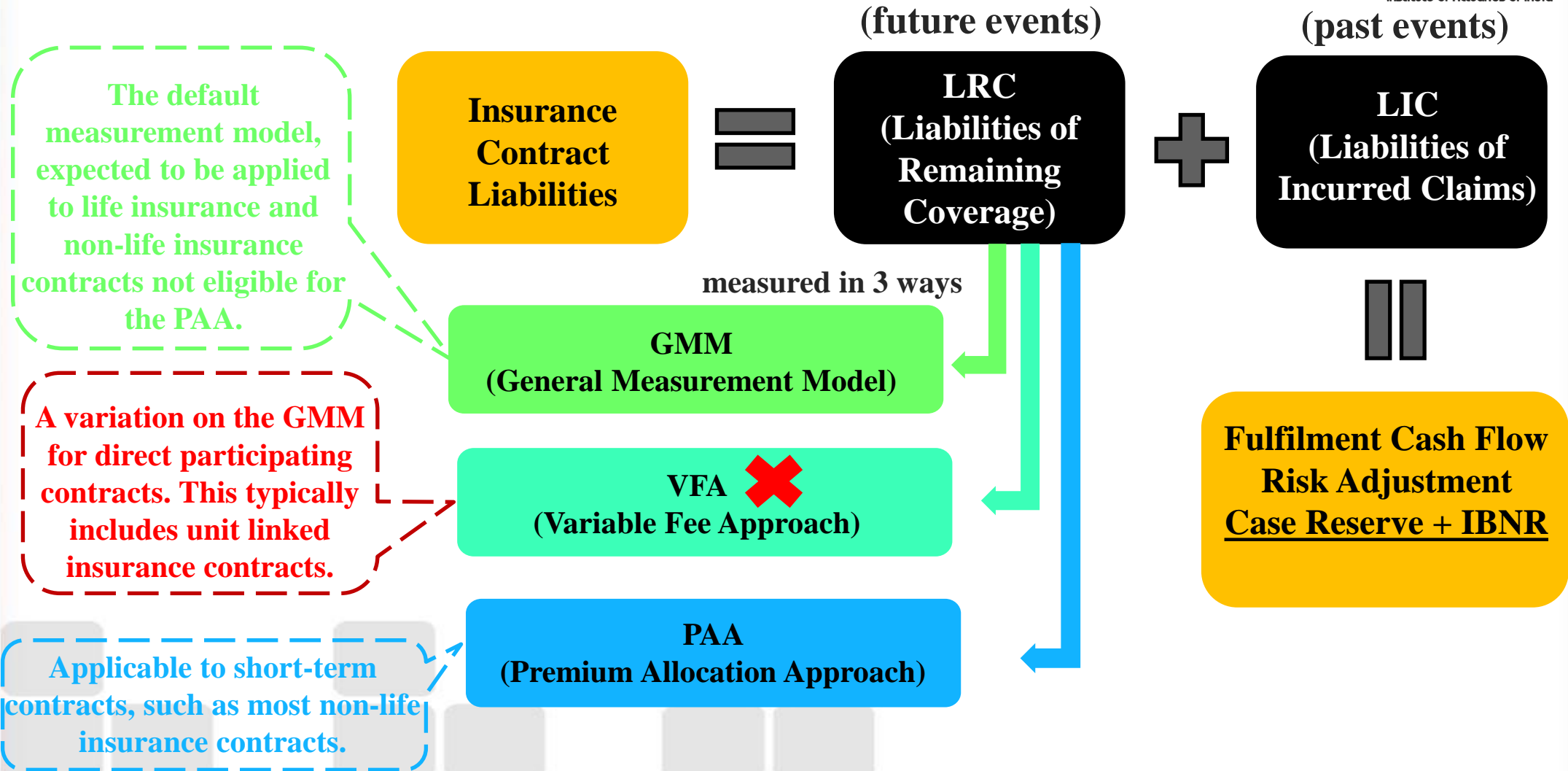
The treatment of an onerous contract differs from that of a profitable contract.

Loss Component (hereinafter referred to as “LC”), depicting the total expected loss under the contract is created in case of an onerous contract and is rolled-forwarded at each subsequent measurement.

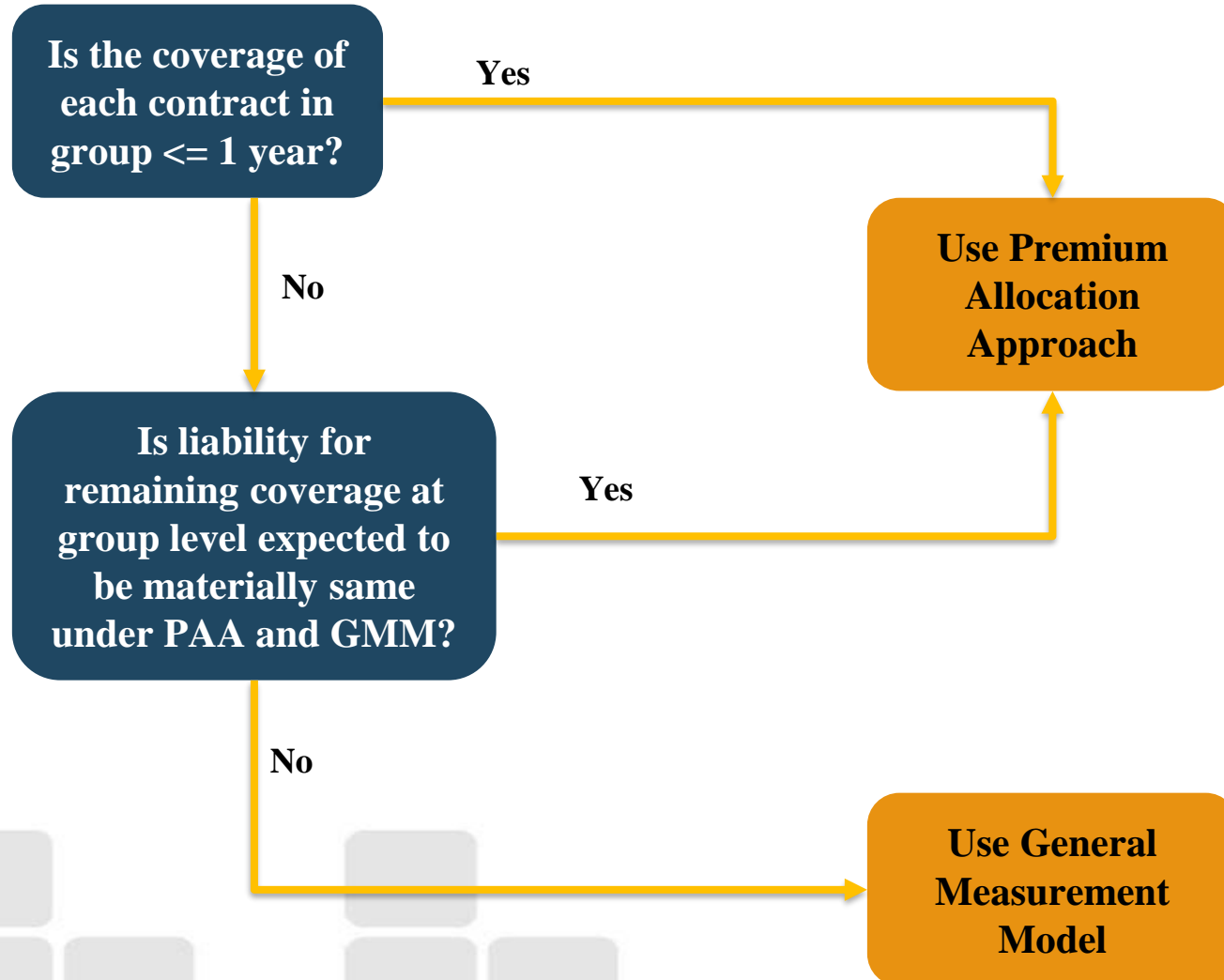
Measurement Models



Measurement Models



PAA Eligibility



Discounting

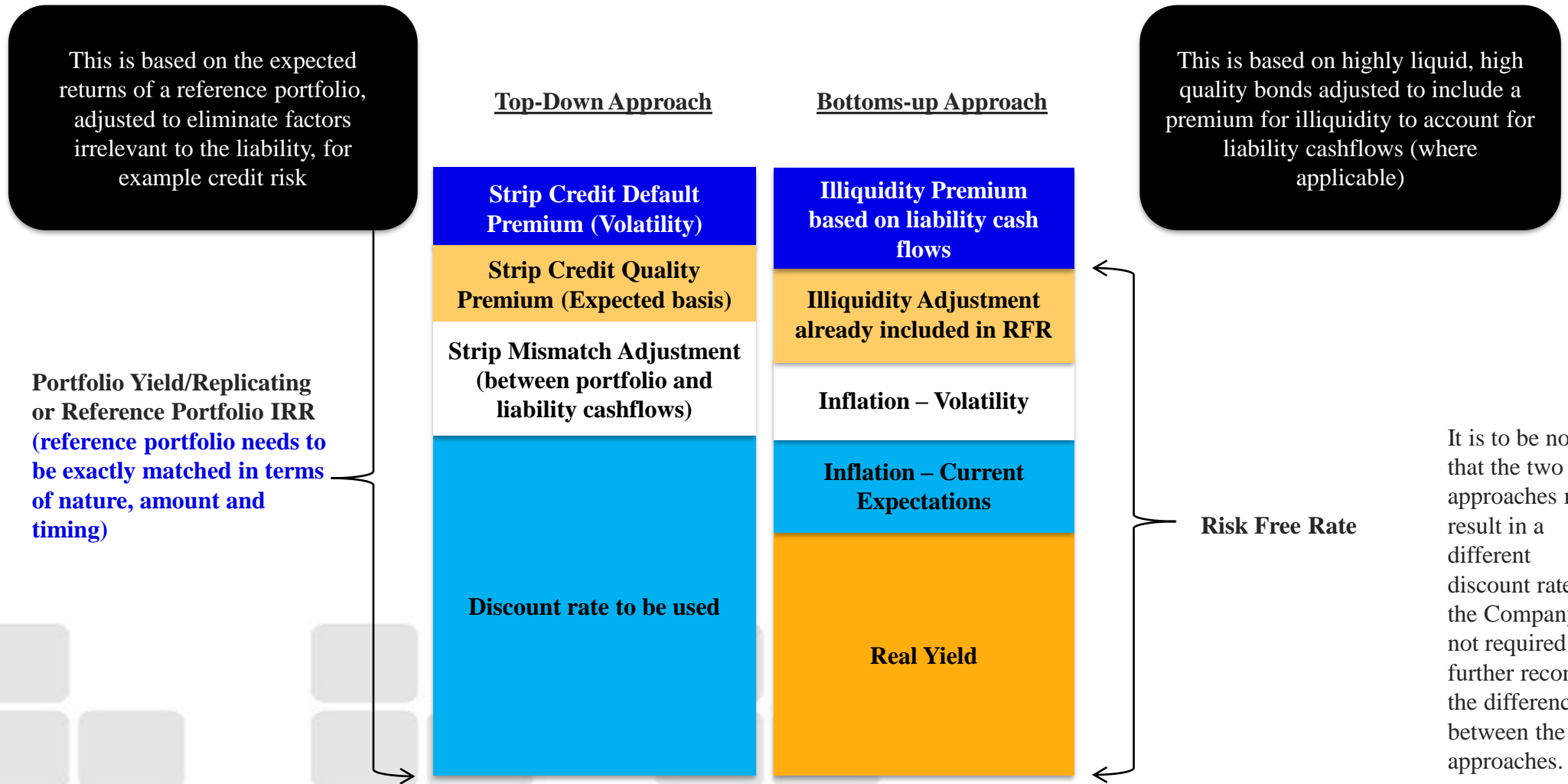


An entity is expected to adjust estimates of future cash flows to reflect the time value of money and the financial risks related to those cash flows. Thereby, discount rates applied shall:

- Reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of insurance contracts
- Be consistent with observable current market prices for financial instruments with cash flows whose characteristics are consistent with those of the insurance contracts, in terms of timing, currency, liquidity
- Exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts

Setting the Discount Rate

The Company can either adopt a bottom-up approach or a top-down approach in setting the discount rate:



It is to be noted that the two approaches may result in a different discount rate and the Company is not required to further reconcile the differences between the two approaches.

Risk Adjustment



The entity is required to adjust the estimate of present value of future cash flows to reflect the compensation the entity itself would require for bearing the risk of uncertainty about the amount and timing of the cash flows arising from non-financial risk.

Possible Approaches:

Cost of Capital (CoC)

This approach is currently used to calculate risk margin under Solvency II. Thus, companies reporting under Solvency II or similar regime may prefer using the CoC approach in calculating the risk adjustment under IFRS 17. This will help save modelling and reporting timelines for IFRS 17 purposes.

Value at Risk (VaR)

The VaR approach is a commonly used method for calculating capital and is used in the Solvency II Standard Formula Method (and even for Internal Model purposes).

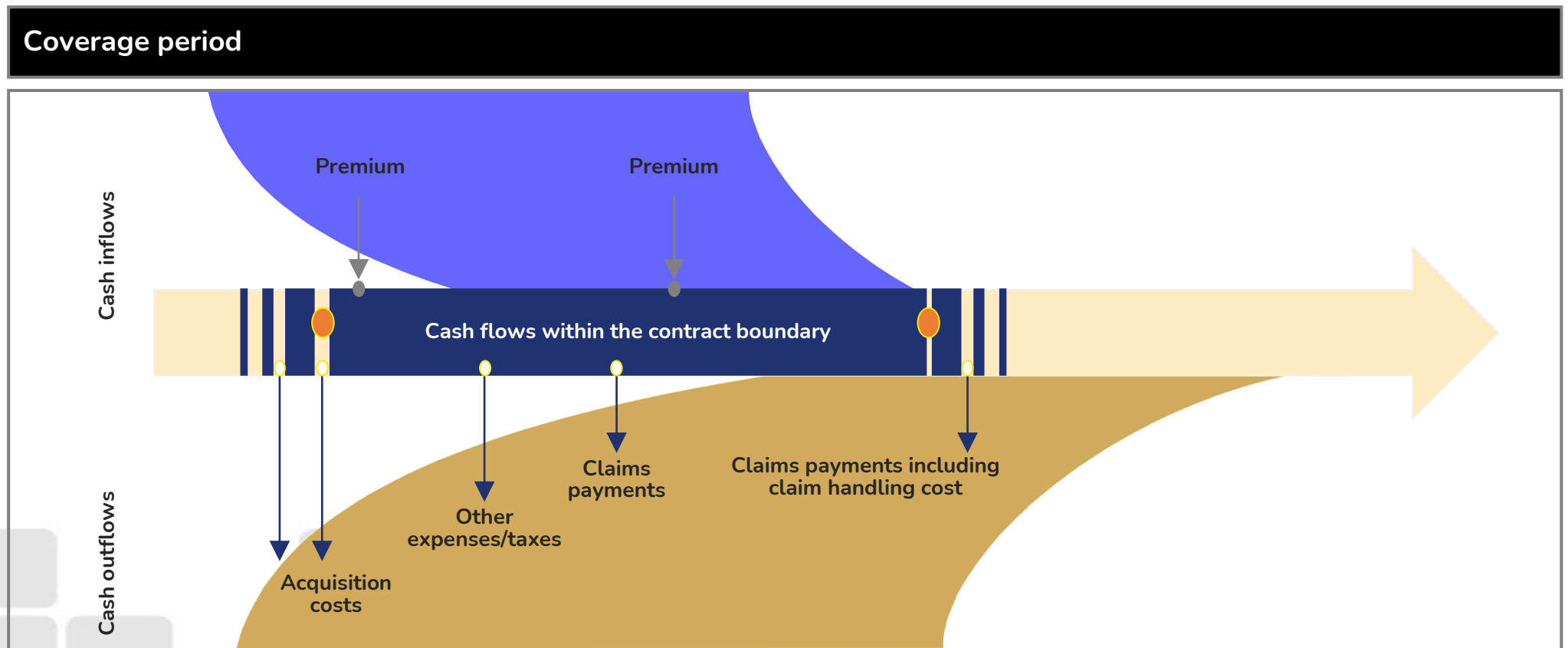
Margin for Adverse Deviation (MAD)

Many of the current reporting regimes use an explicit MAD in valuing the liabilities. To ensure consistency with the existing reporting regime, the Companies can set the risk adjustment as equal to the difference between the cash flows with MAD and those without MAD.

Cashflows

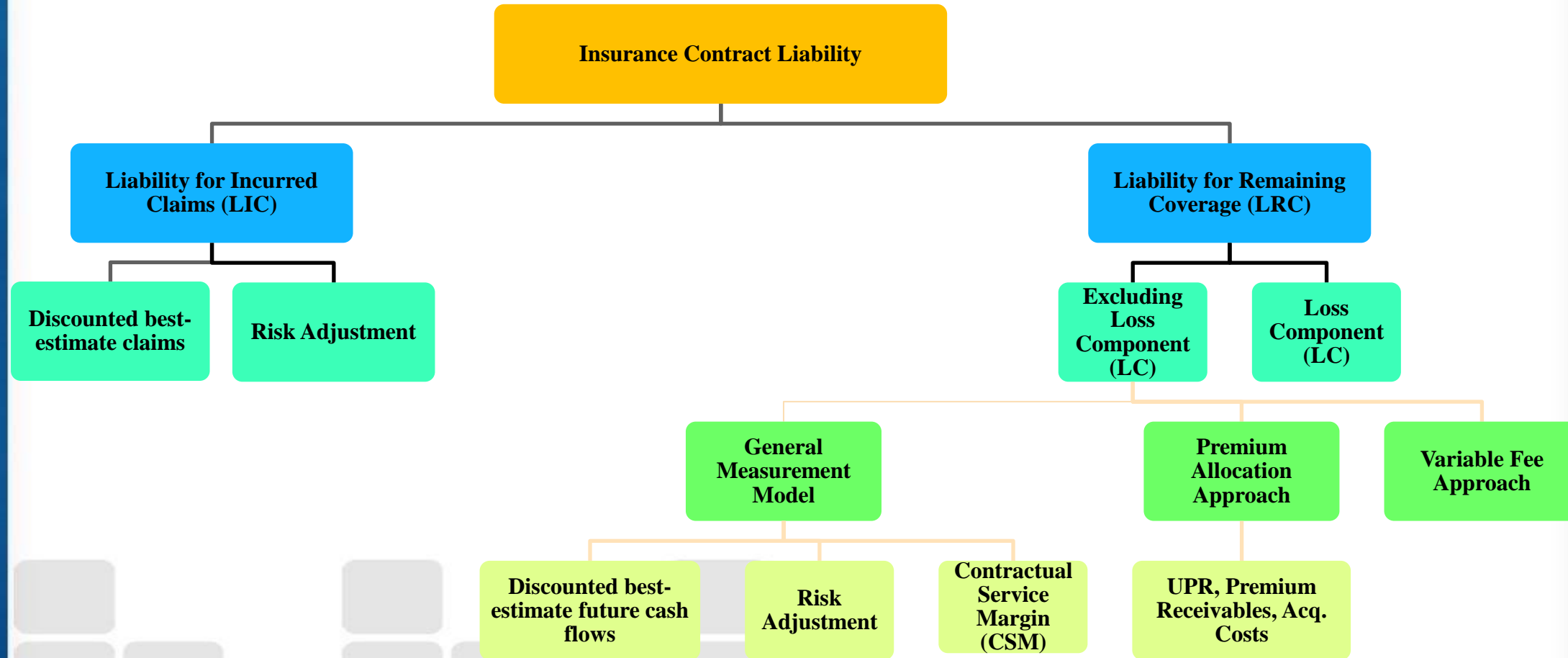
Cashflows

Most common cashflows that fall within the Contract Boundary of a general insurance one year policy are as under:



Fulfilment Cash Flows (FCF)

FCF: “a risk-adjusted present value of the future cash flows (the fulfilment cash flows)”

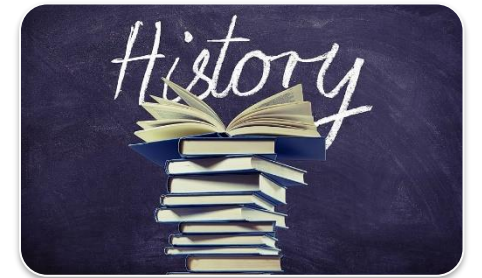


Disclaimers

- The computations are simplified for demonstration and discussion purposes
- One portfolio/group sample projections under IndAS 117 is taken into consideration
- It is assumed that there is no reinsurance for the portfolio considered
- Acquisition costs are not considered in these projections
- Investment income is not considered in these projections
- The sample calculations performed during the workshop are not the only method as per the standard and variations are possible from entity to entity

Liability for Incurred Claims (LIC)

Example Calculations



Ind AS 117 definition for liability for incurred claims:

An entity's obligation to:

- (a) *investigate and pay valid claims for insured **events that have already occurred**, including **events that have occurred but for which claims have not been reported** and other incurred insurance expenses; and*
- (b) *pay amounts that are not included in (a) and that relate to:*
 - (i) ***insurance contract services** that have already been provided; or*
 - (ii) *any **investment components** or other amounts that are not related to the provision of insurance contract services and that are not in the liability for remaining coverage.*

Liability for Incurred Claims



Insurance Service Expenses

Insurance Finance Income or Expenses: Interest Accretion

Insurance Finance Income or Expenses: Change in Discount Rate

42. An entity shall recognise income and expenses for the following changes in the carrying amount of the liability for incurred claims:

- (a) *insurance service expenses—for the increase in the liability because of claims and expenses incurred in the period, excluding any investment components;*
- (b) *insurance service expenses—for any subsequent changes in fulfilment cash flows relating to incurred claims and incurred expenses; and*
- (c) *insurance finance income or expenses—for the effect of the time value of money and the effect of financial risk as specified in paragraph 87.*

Liability for Remaining Coverage (LRC)

Example Calculations PAA



LRC

Ind AS 117 definition for liability for remaining coverage:

*An entity's obligation to investigate and pay valid claims under **existing insurance contracts for insured events that have not yet occurred** (ie the obligation that relates to the unexpired portion of the coverage period).*

Liability for Remaining Coverage (PAA)



Insurance Revenue

Insurance Finance Income or Expense: Interest Accretion

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 recognise 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 recognised 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 recognise the payments as an expense applying paragraph 59(a); (iii) plus any amounts relating to the amortisation of insurance acquisition cash flows recognised as an expense in the reporting period; unless the entity chooses to recognise 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 recognised 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.

Thank you