IFRS 17 & Solvency II Workshop
Reinsurance Held and Contracts Acquired

Carlos Arocha, FSA

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Agenda

Monday, 15 July	Tuesday, 16 July	Wednesday 17 July
• Recap of IFRS 17 Background • General Measurement Model • Reinsurance Held and Contracts Acquired • Implementing IFRS 17	• Measurement of direct participation contracts • Illustrative examples of the Premium Allocation Approach • Presentation of IFRS 17 Results • Data management and calculation engines • Background and Scope of Solvency II • Quantitative Aspects of Solvency II	• Quantitative Aspects of Solvency II (cont'd) • Governance under Solvency II • The Risk Management & Reporting Processes

Reinsurance Contracts Held

Summary of paragraph 63

In applying measurent requirements to reinsurance contracts held, the entity shall use assumptions that are consistent to those used in measuring the underlying contracts.

In addition, the entity shall include the effect of any risk of non-performance of the reinsurer, including the effects of collaterla and losses from disputes.

Summary of paragraph 65

In the determination of the CSM for reinsurance held, there is no unearned profit but instead a net cost or net gain on purchasing the reinsurance. Hence, on initial recognition:

a) the entity shall recognize any net cost or net gain as CSM, measured as the sum of:
   - fulfilment cash flows;
   - amount derecognized of any asset or liability previously recognized; and
   - any cash flows arising at the date of recognition; unless

b) the net cost of purchasing reinsurance relates to events that occured before the purchase of the group of reinsurance contracts, in which case, the entity shall recognize such a cost immediately as an expense

Initial recognition—analysis

For the underlying group of insurance contracts assume the following recognition:

Insurance contract (asset) / liability on initial recognition	
Estimates of the present value of cash inflows	–1,000.00
Estimates of the present value of cash outflows	649.42
Estimates of the present value of cash flows	–350.58
Risk adjustment for non-financial risk	75.00
Fulfilment cash flows	–275.58
Contractual service margin	275.58
Insurance contract (asset) / liability on initial recognition	**0.00**

Assume further that the entity enters into a reinsurance contract that covers 20% of each claim in return of a reinsurance premium of (a) 120.00; or (b) 150.00

Initial recognition of reinsurance held

On initial recognition:

Reinsurance contract asset on initial recognition			
	Premium 120.00	**Premium 150.00**	
Estimates of the present value of cash inflows (recoveries)	–129.88	–129.88	20% of paid claims
Estimates of the present value of cash outflows (reinsurance premium)	120.00	150.00	
Estimates of the present value of cash flows	–9.88	20.12	
Risk adjustment for non-financial risk	–15.00	–15.00	20% of original risk adjustment
Fulfilment cash flows	–24.88	5.12	
Contractual service margin of the reinsurance contract held	24.88	–5.12	
Reinsurance contract asset on initial recognition	**0.00**	**0.00**	
Proft / (loss) on initial recognition	**0.00**	**0.00**	There is no unearned profit

- Risk of non-performance of the reinsurer is ignored here for simplicity

Subsequent measurement

Assume that immediately before the end of year 1, the entity performs the following measurement:

Insurance contract liability / (reinsurance contract asset) immediately before the end of year 1		
	Insurance liability	**Reinsurance asset**
Fulfilment cash flows (before effect of any changes in estimates)	550.00	–220.00
Contractual service margin	165.00	–60.00
Insurance contract liability / (reinsurance contract asset) before year-end	**715.00**	**–280.00**

assume 40%

application of paragraph 66

At the end of year 1:

Insurance contract liability / (reinsurance contract asset) at year-end		
	Insurance liability	**Reinsurance asset**
Fulfilment cash flows (including effect of changes in estimates)	600.00	–240.00
Contractual service margin	115.00	–40.00
Insurance contract liability / (reinsurance contract asset) at year-end	**715.00**	**–280.00**
Profit / (loss)	**0.00**	**0.00**

The CSM of the reinsurance contract is adjusted following changes in fulfilment cash flows

Summary of paragraph 66

An entity shall measure the CSM for reinsurance conttracts held as the carrying amount determined at the start of the period, adjusted for:

a) the effect of any new contracts added to the group;
b) interest accreted on the CSM;
c) changes in the fulfilment cash flows to the extent that the change:
   - relates to future service; unless
   - the change results from a chainge in fulfilment cash flows allocated to a group of underlying contacts that does not adjust the CSM for the group of such underlying contracts
d) the effect of any currency exchange differences arising on the CSM; and
e) the amount recognized in profit or loss of services received in the period, determined by the allocation of the CSM remaining at the end of the period (before allocation) over the current and remaining coverage period of the group of reinsurance contracts held

Subsequent measurement—onerous group

Assume that immediately before the end of year 1, the entity performs the following measurement:

Insurance contract liability / (reinsurance contract asset) immediately before the end of year 1		
	Insurance liability	**Reinsurance asset**
Fulfilment cash flows (before effect of any changes in estimates)	550.00	–220.00
Contractual service margin	165.00	–60.00
Insurance contract liability / (reinsurance contract asset) before year-end	**715.00**	**–280.00**

assume 40%

application of paragraph 66

At the end of year 1:

Insurance contract liability / (reinsurance contract asset) at year-end		
	Insurance liability	**Reinsurance asset**
Fulfilment cash flows (including effect of changes in estimates)	825.00	–330.00
Contractual service margin	0.00	6.00
Insurance contract liability / (reinsurance contract asset) at year-end	**825.00**	**–324.00**
Profit / (loss)	**–110.00**	**44.00**

loss = 66.00

The CSM of the reinsurance contract is adjusted following changes in fulfilment cash flows

Insurance Contracts Acquired

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Paragraph B94 –summary

An entity shall use the consideration received or paid for the contracts as a proxy for the premiums received. The consideration excludes considerations for any other assets or liabilities acquired in the same transaction. In a business combination, the consideration is the fair value of the contracts at that date.

Initial recognition of contracts acquired in a transfer

Assume that an entity acquires insurance contracts from another insurer. The insurance contracts form one group. The entity receives a payment of 300 and on initial recognition the fulfilment cash flows are either a net outflow of (a) 200; or (b) 450

Analysis on initial recognition		
	Net outflow 200	**Net outflow 450**
Fulfilment cash flows	200	450
Contractual service margin	100	--
Insurance contract liability on initial recognition	300	450
The effect on profit or loss will be:		
Profit / (loss) on initial recognition	**--**	**–150**

positive net outflows are really liabilities

onerous on
initial recognition

Paragraph B95 –summary

Unless the PAA is used, on initial recognition the contractual service margin is calculated applying paragraph 38 for acquired insurance contracts issued and paragraph 65 for acquired reinsurance contracts held using the consideration received or paid as a proxy for the premiums received or paid on initial recognition.

If acquired contracts are onerous, the entity shall recognize the excess of the fulfilment cash flows over the consideration paid or received as part of goodwill or gain on a bargain purchase for contracts acquired in a business combination, or as a loss for contracts acquired in a transfer.

The entity shall establish a loss component of the liability for remaining coverage for that excess, and allocate subsequent changes in fulfilment cash flows to that loss component.

Initial recognition of contracts acquired in a business combination

Assume that an entity acquires insurance contracts as part of a business combination, that results in goodwill (IFRS 3 *Business Combinations*.) The insurance contracts form one group. The fair value of the contracts is 300 and on initial recognition the fulfilment cash flows are either a net outflow of (a) 200; or (b) 450

Analysis on initial recognition		
	Net outflow 200	**Net outflow 450**
Fulfilment cash flows	200	450
Contractual service margin	100	--
Insurance contract liability on initial recognition	300	450
The effect on profit or loss will be:		
Profit / (loss) on initial recognition	**--**	--

positive net outflows are really liabilities

the excess of fulfilment cash flows over the fair value is recognized as part of goodwill

Carlos Arocha
ca@ArochaAndAssociates.ch

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