

IND AS 117 / IFRS 17

Insurance Contracts Explained

Understanding the Revolutionary Accounting Standard



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Why Should You Care About IFRS 17?

The Biggest Change in Insurance Accounting

Think of it like this: Before IFRS 17, insurance companies could report their numbers in hundreds of different ways. It was like everyone using a different language to describe the same thing!

What Changed?

- Companies can't hide bad news in future years anymore
- Everything is measured at current value, not old historical costs
- Investors can actually compare different insurance companies
- Effective from January 1, 2023 (India: Not notified yet by MCA)

The Problem We Had Before IFRS 17

✗ The Old Way (IFRS 4)

Company A sells a policy for ₹1,00,000
Shows profit: ₹30,000

Company B sells SAME policy
Shows profit: ₹15,000

Both are 'correct' under old rules!

✓ The New Way (IFRS 17)

Both companies use:

- Same measurement method
- Current market assumptions
- Time value of money

Result: Comparable numbers!

Imagine comparing two phones where one company measures screen size in inches and the other in centimeters - that was insurance accounting before IFRS 17!

What Does IFRS 17 Cover?

✓ INCLUDED

- Life Insurance
All life policies, term plans, ULIPs
- General Insurance
Health, motor, property, liability
- Reinsurance Contracts
Both issued and held
- Investment Contracts with DPF
Discretionary Participation Features

✗ EXCLUDED

- Product Warranties
Covered under IAS 37 or IFRS 15
- Employer Benefit Plans
Like provident fund, gratuity (IAS 19)
- Pure Investment Products
No insurance risk, only investment
- Fixed-Fee Service Contracts
No insurance risk transfer

Three Ways to Measure Insurance Contracts

1. General Model (GMM)

For: Long-term contracts
(Life insurance)

Most complex method

Includes:

- Future cash flows
- Discount rates
- Risk adjustment
- CSM (profit margin)

2. PAA

For: Short-term contracts
(Health, motor, ≤ 12 months)

Simplified approach

Like unearned premium:

- Collect ₹12,000 premium
- Recognize ₹1,000/month
- Much simpler!

3. VFA

For: Participation contracts
(ULIPs, with-profit policies)

Customer shares in returns

Example:

Your money grows with fund
Fund up 20% = Your value up
Modified GMM approach

The Building Blocks of GMM

Think of it like building a house - you need all these pieces:

1 Future Cash Flows (FCF)

All money coming in and going out over policy lifetime

2 Discount Rate

Today's value of future money (time value)

3 Risk Adjustment (RA)

Extra buffer for uncertainty (things might go wrong)

4 CSM (Profit Margin)

Unearned profit - released over time as service provided

$$\text{Liability} = \text{FCF} + \text{Discount} + \text{Risk Adjustment} + \text{CSM}$$

Real Example: Life Insurance Policy (GMM)



Policy Details

- Premium: ₹1,00,000/year for 10 years
- Sum Assured: ₹25,00,000
- Policy Term: 20 years
- Age: 30 years old, healthy male



Calculation at Day 1

Future Cash Inflows:

₹10,00,000 (10 yrs × ₹1L)

Future Cash Outflows:

Expected claims: ₹6,50,000

Expenses: ₹1,20,000



Building Block Values

PV of Cash Flows: ₹2,30,000

Risk Adjustment: + ₹35,000

CSM (Expected Profit): + ₹65,000

Total Liability: ₹3,30,000

The CSM: Your Profit Locked in a Time Vault

Contractual Service Margin = Future profit you EARNED but can't recognize yet

Why can't we recognize profit immediately?

Simple Analogy:

You run a gym. Someone pays ₹12,000 for a 1-year membership on January 1st.

Can you say you earned all ₹12,000 profit on Day 1? NO!

Why? Because you still have to provide gym access for 12 months.

Same with Insurance:

- Premium received on Day 1
- But insurance coverage provided over 20 years
- CSM releases profit gradually as coverage is provided
- **This prevents companies from showing fake profits upfront!**

How CSM Gets Released Over Time



Example: ₹60,000 CSM over 20-year policy

Year	Coverage Units	CSM Released	Remaining CSM
1	₹25,00,000	₹3,000	₹57,000
2	₹25,00,000	₹3,000	₹54,000
5	₹25,00,000	₹3,000	₹45,000
10	₹25,00,000	₹3,000	₹30,000
15	₹25,00,000	₹3,000	₹15,000
20	₹25,00,000	₹3,000	₹0

Key Point:

Each year, as the company provides insurance coverage (service), it 'earns' ₹3,000 of profit. This makes financial statements reflect reality - profit is recognized as service is delivered, not when cash is received!

Premium Allocation Approach (PAA)

The simplified method for short-term contracts

✓ When Can You Use PAA?

- Coverage period ≤ 12 months
Annual car insurance ✓
Annual health insurance ✓
- OR result approximates GMM

Benefits:

- Much simpler calculations
- Less data requirements
- Lower implementation costs
- Faster month-end close

Simple Example

Motor Insurance Policy

Premium: ₹24,000 (1 year)

Policy starts: January 1

Recognition:

- Jan 1: Receive ₹24,000
- Jan 31: Earn ₹2,000 (1/12)
- Feb 28: Earn ₹2,000 (1/12)
- ... continues monthly
- Dec 31: Earn ₹2,000 (1/12)

Unearned premium reduces each month as coverage is provided!

Onerous Contracts: When Things Go Wrong

Onerous = Loss-making contract where claims will exceed premiums

 **Real Example:** Health insurance during pandemic - claims skyrocketed way beyond premiums collected



The Numbers

Health Policy Sold (Pre-Covid):

- Expected claims: ₹8,00,000
- Premiums: ₹10,00,000
- Expected profit: ₹2,00,000 ✓

After Covid Wave:

- Revised expected claims: ₹15,00,000
- Premiums (unchanged): ₹10,00,000
- **Expected LOSS: ₹5,00,000** ✗



Accounting Treatment

Step 1: Recognize Loss Immediately

No hiding it in future years!

- CSM = 0 (wiped out first)
- Loss component = ₹5,00,000
- Show in P&L immediately

Step 2: Update Over Time

- Reversal if conditions improve

Why This Matters:

Investors see the bad news NOW, not spread over future years. This is transparency!

Discount Rates: Time Value of Money

₹100 today ≠ ₹100 in 10 years. We need to adjust for this!

Simple Example

Would you rather have:

- Option A: ₹10,000 today
- Option B: ₹10,000 after 5 years

Obviously A! Because:

You could invest ₹10,000 today and have ₹15,000 in 5 years

Insurance Application

Claim of ₹25,00,000 expected in Year 15

Present Value (at 7% discount):

$$= ₹25,00,000 \div (1.07)^{15}$$

$$= ₹9,05,000 \text{ (approx)}$$

So we set aside ₹9L today, not ₹25L!

What Rate to Use?

Top-down approach: Start with current market rates (G-Sec yields) + adjustments

Bottom-up approach: Start with risk-free rate + liquidity premium + other factors

Must reflect characteristics of insurance liabilities - not company's own credit risk!

Risk Adjustment: The Uncertainty Buffer

Extra cushion for the fact that insurance is unpredictable

What Is It?

The compensation for bearing uncertainty about:

- Amount of claims
Will it be ₹5L or ₹8L?
- Timing of claims
Will it happen in Year 3 or Year 8?

Think of it like:

When you pack for a trip, you bring extra clothes 'just in case'. Same idea here - the Risk Adjustment is the 'just in case' money.

Calculation Methods

- **Confidence Level Technique**
"75% confident claims won't exceed X"

- **Cost of Capital**
Based on how much capital is tied up

Example Numbers:

Expected claims: ₹10,00,000

Risk Adjustment: +₹1,50,000

Total liability: ₹11,50,000

Higher uncertainty = Higher RA

As time passes & uncertainty reduces, RA decreases

How It Shows Up in Financial Statements



Balance Sheet

Insurance Contract Liabilities:

- Liability for remaining coverage
- Liability for incurred claims

Shown separately from other liabilities



Income Statement

Insurance Revenue

Premium earned + CSM released

Insurance Service Expense

Claims + expenses + RA changes

= Insurance Service Result



Sample P&L Extract (Simplified)

Line Item	Amount (₹ Lakhs)
Insurance Revenue	850
Insurance Service Expense	(620)
Insurance Service Result	230
Investment Income	45
Finance Expense on Insurance	(25)

Transition: Moving from Old to New Standard

How do you restate years of old accounting to the new standard?

Full Retrospective

The Gold Standard:

Recalculate everything as if IFRS 17 always existed

Pros:

- Most accurate
- Fully comparable

Cons:

- Massive effort
- Need old data
- Very expensive

Modified Retrospective

The Practical Approach:

Use simplified methods and proxies

When to use:

When full retrospective is impracticable

Example:

Estimate CSM using current assumptions instead of inception assumptions

Fair Value

Last Resort:

When even modified doesn't work

Use market value at transition date

CSM = zero at transition

Implementation Challenges

Why this is one of the toughest accounting standards ever!



Technology

- Legacy systems can't handle it
- Need new actuarial software
- Massive data requirements
- Integration nightmares

Cost: ₹50-500 Cr for large insurers!



People & Processes

- Actuaries need retraining
- Accountants need actuarial knowledge
- New controls and processes
- Month-end close takes longer

Talent shortage is REAL



Data Quality

- Historical data incomplete
- Need policy-level granularity
- Cash flow projections complex
- Multiple data sources to reconcile



Business Impact

- KPIs change completely
- Investor communication challenge
- Product pricing may need revision
- Management reporting overhaul

Why Go Through All This Pain?

The benefits that make it worthwhile

✓ Comparability

Compare LIC vs HDFC Life vs Max Life on equal footing
Compare across countries too!

✓ Transparency

Investors can see true performance
No more hiding losses in future years

✓ Better Risk Management

Forces companies to measure and manage risks properly
Regular updates to assumptions
Early warning of problems

✓ Realistic Profits

Profit recognized as service delivered
Current values, not outdated historical costs
Reflects economic reality

Key Takeaways

1 IFRS 17 is about matching profit recognition with service delivery

No more front-loading profits or hiding losses in future years. Everything at current value.

2 Three measurement models for different contract types

GMM for complex long-term, PAA for simple short-term, VFA for participation contracts.

3 Building blocks: FCF + Discount + Risk Adjustment + CSM

Each component serves a specific purpose in measuring insurance liability accurately.

4 Massive implementation effort but worth it for transparency

Technology, people, processes all need transformation. But investors finally get comparable numbers.

Thank You!

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