The Actuarial Society of Hong Kong

REINSURANCE

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香 港 精 算 學 會

Definition of reinsurance

Reinsurance contract – per Appendix A (Defined Terms)

"An insurance contract issued by one entity (the 'reinsurer') to compensate another entity for claims arising from one or more insurance contracts issued by that other entity (underlying contracts)"

Scope of application of IFRS 17:

- Reinsurance 'issued': reinsurance from the perspective of the reinsurer
  - Generally treated the same as direct insurance contracts
- Reinsurance 'held': reinsurance from the perspective of the insurer
  - Some differences compared to direct insurance

The remaining slides will focus on the differences to direct insurance.

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Risk transfer

Reinsurance contracts must transfer insurance risk to be accounted for under IFRS 17

- Recap - definition of insurance contract (per Appendix A):

*"A contract under which one party (the issuer) accepts **significant insurance risk** from another party (the policyholder) by agreeing to compensate the policyholder if a specified **uncertain** future event (the insured event) adversely affects the policyholder."*

- Some relevant sections in Appendix B (Application Guidance):
  - A contract transferring lapse, persistency or expense risk to another party exposes the other party to insurance risk (whereas they do not constitute insurance risk for a direct insurance contract).
    - Note: this may be relevant for some types of reinsurance with financing motivations
  - The insured event can be unlikely, it just needs to have commercial substance.
    - e.g. catastrophe reinsurance

Risk transfer

- Some relevant sections in Appendix B (continued):
  - The expected PV of contingent cash flows can be a small proportion of the expected PV of remaining cash flows.
  - Even if a reinsurance contract does not expose the issuer to the possibility of a significant loss, it is deemed to transfer significant insurance risk if it transfers to the reinsurer substantially all the insurance risk relating to the reinsured portions of contracts that meet the definition of insurance.
  - An entity shall assess the significance of insurance risk contract by contract.
    - Note: For reinsurance this is for the group of underlying contracts subject to the reinsurance treaty
  - NOT insurance: *"contracts that return all significant insurance risk to the policyholder through non-cancellable and enforceable mechanisms that adjust future payments by the policyholder to the issuer as a direct result of insured losses"*
    - *Note: this may be relevant for some types of reinsurance with financing motivations.*

Coverage period

Initial Recognition

- If proportionate coverage is provided, reinsurance is recognised from the beginning of the coverage period for the group of reinsurance contracts held, or at the initial recognition of any underlying contract, whichever is the latter
- In other cases, from the beginning of the coverage period of the group of reinsurance contracts held (e.g. excess of loss reinsurance).

Groups of insurance contracts (CSM unit of account)

Application for reinsurance issued is generally in line with requirements for direct insurance.

- Note: One difference is that reinsurance contracts cover underlying contracts issued across multiple years, but any given reinsurance contracts will have only one issue year.

Application for reinsurance held is similar to requirements for direct insurance, except that references in grouping requirements to onerous contracts should be replaced with net gain on issuance.

Measurement

Application for reinsurance issued is generally in line with requirements for direct insurance.

Application for reinsurance held has some key differences:

- Estimated cash flows shall include allowance for the risk of non-performance (incl. effects of collateral and losses from disputes).
- Risk adjustment represents the amount of risk being transferred by the holder of the group of reinsurance contracts to the issuer of those contracts.
  - Therefore, the risk adjustment in respect of reinsurance will be an asset (to reflect the risk being removed from the underlying contracts).
  - Note: Assumptions for gross of reinsurance calculations should be consistent with those for reinsurance calculations.

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Measurement

Application for reinsurance held has some key differences (continued):

- CSM measurement using VFA approach for insurance with DPF cannot be applied.
- CSM is not required to be positive – i.e. onerous requirements do not apply.
  - However, if the underlying contracts are in an onerous group and changes in estimates of fulfilment cash flows are not offset by CSM, then corresponding impacts of changes in estimates on reinsurance fulfilment cash flows are also not offset by CSM.
- Changes in risk of non-performance of reinsurer do not adjust CSM.

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Measurement - PAA

Some forms of reinsurance will qualify for PAA (e.g. catastrophe reinsurance), but not all. In order to be applied:

- PAA must not be expected to give rise to a materially different result; or
- Coverage period for contracts in the group of reinsurance contracts held must be one year or less.
- Note: Even though reinsurance rates may be age-based, if they are guaranteed for a period of greater than one year, the reinsurance contract does not qualify for PAA.

Presentation

On statement of Financial Position, present separately:

- Insurance contracts issued that are assets
- Insurance contracts issued that are liabilities
- Reinsurance contracts held that are assets
- Reinsurance contracts held that are liabilities

On Statement of financial performance, present separately:

- Income or expenses from the group of reinsurance contracts held (other than insurance finance income or expense); OR
- Separately present amounts recovered and an allocation of reinsurance premiums paid that net to the single amount.

Summary

Summary of key differences between reinsurance held and insurance under IFRS 17:

- Measurement
  - Estimated cash flows shall include allowance for the risk of non-performance (incl. effects of collateral and losses from disputes).
  - Risk adjustment represents the amount of risk being transferred by the holder of the group of reinsurance contracts to the issuer of those contracts.
  - VFA method for Insurance with DPF **cannot be applied** to reinsurance held
  - Onerous contract requirements **do not apply** to reinsurance held
  - Changes in risk of non-performance of reinsurer do not adjust CSM.

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Concluding thoughts

- Reinsurance held will require more effort than required under most reporting regimes at present.
  - It will not simply be application of the PAA in most cases
- It will no longer be possible to determine a net of reinsurance liability directly (with reinsurance deemed to be the difference between gross and net of reinsurance liabilities).
- Treatment of direct insurance and reinsurance is not symmetric:
  - Onerous contracts
  - Grouping of contracts
  - Risk of non-performance of reinsurer is taken into account
  - Non-allowance of VFA
- Some aspects of the guidance relating to reinsurance is not perfectly clear.

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