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## IFRS 17 Accounting Policy Paper: Initial and subsequent measurement

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<b>Subject:</b>	Initial and subsequent measurement

### **Disclaimer:**

This accounting policy paper, which is the responsibility of the Facility Association's (FA) management, is prepared solely for the FA as administrator of certain insurance pools, namely the Facility Association Residual Market (FARM) and each of the Risk Sharing Pools (RSPs). It is intended solely for the use of the FA to document management's accounting policy determinations under IFRS 17 as part of management's internal financial reporting and governance processes as applicable to the FARM and each of the RSPs.

This accounting policy paper is being made available through the FA website to member insurance companies for general information purposes only and does not constitute advice from the Facility Association. Member insurance companies are responsible for their own assessment of IFRS 17 as applicable to their financial reporting. We disclaim any responsibility to any member insurance company who may rely on this document.

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## **Purpose**

This paper summarizes Facility Association’s interpretation of the measurement requirements of IFRS 17 and the application of those requirements to contracts issued via the Facility Association Residual Market (“FARM”) and contracts assumed through the Risk Sharing Pools (“RSPs”). This includes determining the measurement model, initial and subsequent measurement of groups of insurance contracts (or a single insurance contract in the case of the RSPs), including accounting policy choices and conclusions reached on key judgments.

## **Entities:**

Facility Association (FA) administers three types of mechanisms on behalf of its membership. This paper covers only the two mechanisms in the scope of IFRS 17, namely:

- Facility Association Residual Market (“FARM”)
- Risk Sharing Pools (“RSPs”)\*

\* Outside the scope of this paper are requirements relating to the direct business issued by the individual members prior to ceding the business to the RSP. Only business assumed via each of the six RSPs will be addressed in this memo.

## **Topics Covered**

The topics covered in this paper are as follows:

1. Premium Allocation Approach (PAA) Eligibility: Is each group of contracts eligible for the PAA?
2. Measurement at Initial Recognition: How will each group of contracts be measured at initial recognition?
3. Subsequent Measurement: How will each group of contracts be subsequently measured?
4. Onerous groups of insurance contracts: How will each group of contracts be assessed to be onerous?

## **Dependencies and Relationships**

The technical positions developed in this paper affect (i.e., have downstream dependency on) the conclusions of the following papers:

1. Scope
2. Level of aggregation
3. Initial recognition and contract boundary
4. Insurance acquisition cash flows
5. Risk adjustment
6. Discount rate
7. Transition
8. Modification and extinguishment of insurance contract

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## Executive Summary

FA reached the following conclusions regarding the requirements of IFRS 17 relating to measurement and the application of those requirements to contracts issued via the FARM and contracts assumed through the RSPs:

1. Is each group of contracts eligible for the PAA?
  - a. FARM:

As the coverage period of each contract associated with FARM is up to 12 months, each group of contracts is eligible for the PAA.
  - b. RSP:

As the coverage period of each contract in the group (there is only one contract per group) is 12 months, each group of contracts is eligible for the PAA.
2. How will each group of contracts be measured at initial recognition?
  - a. FARM:
    - i. The carrying amount of the liability for remaining coverage (LRC) is expected to be calculated as the premiums received by brokers/Servicing Carriers (regardless of whether they have been remitted to FA) less any acquisition cash flows.
    - ii. Whether a significant financing component exists was not assessed as FARM policies qualify for the practical expedient.
  - b. RSP:
    - i. The carrying amount of the LRC is expected to be calculated as the premiums received by the RSPs.
    - ii. Whether a significant financing component exists was not assessed as RSPs qualify for the practical expedient.
3. How will each group of contracts be subsequently measured?
  - a. FARM:
    - i. The LRC will be adjusted as follows:
      1. Opening balance
      2. Add: Premiums received in the period = premiums received by brokers/Servicing Carriers, regardless of whether they have been remitted to FA
      3. Less: Amortization of insurance acquisition cash flows
        - a. Insurance acquisition cash flows will be deferred and amortized in a pattern consistent with insurance revenue
      4. Less: Insurance revenue, which will be recognized in accordance with passage of time.
    - ii. The liability for incurred claims (LIC) is expected to be adjusted for the time value of money and the effect of financial risks as the settlement of claims is likely to occur in greater than one year's time from the date claims are incurred.

- b. RSP:
  - i. The LRC will be adjusted as follows:
    - 1. Opening balance
    - 2. Add: Premiums received in the period = premiums received by the RSPs
    - 3. Less: Insurance revenue, which will be recognized in accordance with passage of time
  - ii. The LIC is expected to be adjusted for the time value of money and the effect of financial risks as the settlement of claims is likely to occur in greater than one year's time from the date claims are incurred.
- 4. How will each group of contracts be assessed to be onerous?
  - a. FARM:
    - i. When assessing the 'facts and circumstances' to determine if the group of contracts may be onerous:
      - 1. Prior to recognition of a group of contracts, FA will consider (Refer to Level of Aggregation memo):
        - a. The expectation of a fulfilment ratio<sup>1</sup> greater than 100%;
        - b. Previous cohorts and whether they:
          - i. Had fulfilment ratios greater than 100%; or
          - ii. Were onerous (at initial recognition or subsequently)
      - 2. In addition, on a calendar annual basis, FA will consider:
        - a. Current expectations of fulfilment ratios;
        - b. Unfavorable experience trends;
        - c. Unfavorable external or other conditions.
    - ii. RSP:
      - i. The same analysis as FARM will be performed prior to recognition as well as on a quarterly basis to determine if a group of contracts (in the case of each of the RSPs, only one contract) may be onerous.
      - ii. As the general expectation is that the RSPs will operate on an overall basis at a financial loss, policies associated with the RSPs will be assumed to have the facts and circumstances indicate onerousness at initial recognition.

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<sup>1</sup> Fulfilment ratio is defined as: expected insurance service expenses / insurance revenue on a present value basis (e.g. present value of claims, attributable expenses and including risk adjustment divided by present value of expected insurance premiums). The fulfilment ratio is specific to each cohort (i.e. favorable development on prior cohort would not be included in the current cohort projected fulfilment ratio).

**Question 1: Is each group of contracts eligible for the PAA?**

***Technical References and Guidance***

**IFRS 17 Standard**

53 An entity may simplify the measurement of a group of insurance contracts using the premium allocation approach set out in paragraphs 55–59 if, and only if, at the inception of the group:

- (a) the entity reasonably expects that such simplification would produce a measurement of the liability for remaining coverage for the group that would not differ materially from the one that would be produced applying the requirements in paragraphs 32–52; or
- (b) the coverage period of each contract in the group (including insurance contract services arising from all premiums within the contract boundary determined at that date applying paragraph 34) is one year or less.

54 The criterion in paragraph 53(a) is not met if at the inception of the group an entity expects significant variability in the fulfilment cash flows that would affect the measurement of the liability for remaining coverage during the period before a claim is incurred. Variability in the fulfilment cash flows increases with, for example:

- (a) the extent of future cash flows relating to any derivatives embedded in the contracts; and
- (b) the length of the coverage period of the group of contracts.

App A - Coverage period:

The period during which the entity provides insurance contract services. This period includes the insurance contract services that relate to all premiums within the boundary of the insurance contract.

App A - Insurance contract services:

The following services that an entity provides to a policyholder of an insurance contract:

- (a) coverage for an insured event (insurance coverage);
- (b) for insurance contracts without direct participation features, the generation of an investment return for the policyholder, if applicable (investment-return service); and
- (c) for insurance contracts with direct participation features, the management of underlying items on behalf of the policyholder (investment-related service).

BC283 Consistent with the requirements in IFRS 15, the settlement of a liability is not considered to be a service provided by the entity. Thus, the recognition period for the contractual service margin is the coverage period over which the entity provides the coverage promised in the insurance contract, rather than the period over which the liability is expected to be settled. The margin the entity recognises for bearing risk is recognised in profit or loss as the entity is released from risk in both the coverage period and the settlement period.

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### **Technical Analysis**

Following the guidance set out above, IFRS 17.53 indicates that an entity may simplify the measurement of a group of insurance contracts using the premium allocation approach (PAA) if, and only if, at the inception of the group:

- a) the entity reasonably expects that such simplification would produce a measurement of the liability for remaining coverage (LRC) for the group that would not differ materially from the one that would be produced applying the general measurement model; or
- b) the coverage period of each contract in the group is one year or less.

IFRS 17 Appendix A defines the coverage period as “the period during which the entity provides insurance contract services. This period includes the insurance contract services that relate to all premiums within the boundary of the insurance contract.”

An assessment is made below with regards to the coverage period of the policies associated with FARM and the RSPs.

### **FARM**

As noted in the initial recognition and contract boundary policy paper, subsequent to the issue date, the issuer of the insurance contract is obligated to provide coverage to the underlying policyholder. Once the policy has been issued, there is a substantive obligation to provide services for the coverage during the contractual term.

The contractual term for policies associated with the FARM has been assessed to be up to 12 months. Insurance contract services are provided during the twelve-month period as coverage for an insured event will be provided to the policyholder during this time period.

Additionally, the contract boundary for policies associated with FARM has been assessed to include 12 months of expected premiums, claims and expenses (see initial recognition and contract boundary policy paper).

Payment of claims associated with the insured event will likely be paid subsequent to the 12-month coverage period. However, as supported by IFRS 17.BC283, the subsequent payment of claims (i.e. settlement of a liability) is not considered to reflect insurance contract services.

Therefore, the coverage period is 12 months for each contract within the group as a result of the contractual terms of each policy associated with FARM.

**As the coverage period of each contract associated with FARM is 12 months, each group of contracts is eligible for the PAA.**

## RSP

The financial results of each of the RSPs are pooled among all participating insurance companies licensed to write automobile insurance in the applicable province, who are required by law to belong to the Facility Association. The financial results are calculated on an accident year basis.

As noted within the scope policy paper, the contract for IFRS 17, in relation to the RSPs, is similar to a facultative-obligatory reinsurance treaty written on a losses-occurring-during basis.

As a result, insurance contract services in relation to the policies associated with the RSPs are provided to the policyholders during a one-year term (i.e. the accident year). Therefore, the coverage period for these policies has been assessed to be 12 months.

**As the coverage period of each contract in the group (there is only one contract per group) is 12 months, each group of contracts is eligible for the PAA.**

## Technical Position

Mechanism	Technical Position
FARM	As the coverage period of each contract associated with FARM is 12 months, each group of contracts is eligible for the PAA.
RSP	As the coverage period of each contract in the group (there is only one contract per group) is 12 months, each group of contracts is eligible for the PAA.



**Question 2: How will each group of contracts be measured at initial recognition?**

***Technical References and Guidance***

**IFRS 17 Standard**

- 27 An entity shall recognise an asset or liability for any insurance acquisition cash flows relating to a group of issued insurance contracts that the entity pays or receives before the group is recognised, unless it chooses to recognise them as expenses or income applying paragraph 59(a). An entity shall derecognise the asset or liability resulting from such insurance acquisition cash flows when the group of insurance contracts to which the cash flows are allocated is recognised.
- 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.
- 56 If insurance contracts in the group have a significant financing component, an entity shall adjust the carrying amount of the liability for remaining coverage to reflect the time value of money and the effect of financial risk using the discount rates specified in paragraph 36, as determined on initial recognition. The entity is not required to adjust the carrying amount of the liability for remaining coverage to reflect the time value of money and the effect of financial risk if, at initial recognition, the entity expects that the time between providing each part of the services and the related premium due date is no more than a year.
- 59 In applying the premium allocation approach, an entity:
- (a) may choose to recognise any insurance acquisition cash flows as expenses when it incurs those costs, provided that the coverage period of each contract in the group at initial recognition is no more than one year.
  - (b) shall measure the liability for incurred claims for the group of insurance contracts at the fulfilment cash flows relating to incurred claims, applying paragraphs 33–37 and B36–B92. However, the entity is not required to adjust future cash flows for the time value of money and the effect of financial risk if those cash flows are expected to be paid or received in one year or less from the date the claims are incurred.
- B66A Before the recognition of a group of insurance contracts, an entity might be required to recognise an asset or liability for cash flows related to the group of insurance contracts other than insurance acquisition cash flows either because of the occurrence of the cash flows or because of the requirements of another IFRS Standard. Cash flows are related to the group of insurance contracts if those cash flows would have been included in the fulfilment cash flows at the date of initial recognition of the group had they been paid or received after that date. To apply paragraph 38(c)(ii) an entity shall derecognise such an asset or liability to the extent that the asset or liability would not be recognised separately from the group of insurance contracts if the cash flow or the application of the IFRS Standard occurred at the date of initial recognition of the group of insurance contracts.

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### **Technical Analysis**

The measurement of the LRC is impacted by premiums received, both at initial recognition and subsequently. In general, premiums received means premiums actually received. However, a question arises with respect to how to treat premiums due under an insurance contract to an intermediary – when the intermediary has not yet remitted premiums to the insurer.

In these cases, if the intermediary is acting on behalf of the:

- policyholder (i.e. in the event of default by the intermediary, the insurer can either enforce payment of the premium by the policyholder or cancel the insurance contract), the premium receivable has arisen from an insurance contract, so it should be accounted for in accordance with IFRS 17.
- insurer (i.e. in the event of default by the intermediary, the insurer is still obliged to fulfil its obligations to the policyholder under the contract), the premium receivable is a separate right not arising under an insurance contract, so it should be accounted for in accordance with IFRS 9.

Insurance acquisition cash flows (if they exist) will be deferred and amortized in a pattern consistent with insurance revenue. (Refer to the policy paper on insurance acquisition cash flows for further details.)

While significant financing components do not impact measurement at initial recognition, an assessment is required to be performed as to whether a significant financing component exists. IFRS 17 is not clear when a significant financing component exists, but per IFRS 17.56, an entity does not need to reflect the time value of money and effect of financial risk when the time between providing insurance contract services and the related premium due date is less than one year.

### **FARM**

Under the FARM, agents and brokers who are unable to find automobile insurance coverage for one of their clients can contact a servicing carrier who will issue a policy for the particular client on behalf of FA's members (as The Collective).

Brokers have binding authority and act on behalf of The Collective (FARM), so premiums collected by brokers from policyholders, regardless of whether they have been remitted to the Servicing Carriers or to The Collective, are considered "received" for purposes of IFRS 17.55. Premiums due from the policyholder to the brokers do not impact the measurement of the LRC under IFRS 17.

Any cost designated as "insurance acquisition costs" incurred by the Servicing Carrier will be taken into consideration when calculating the carrying amount of the liability for remaining coverage at initial recognition. (Refer to the insurance acquisition cash flow policy paper for more details on these costs.)

Facility Association did not conclude on whether a significant financing component exists for each group of contracts. This is because regardless of jurisdiction, the group of contracts would qualify for the practical expedient (i.e. the entity is not required to adjust the carrying amount of the LRC to reflect the time value of money and the effect of financial risk if, at initial recognition, the entity expects that the time between providing each part of the services and the related premium due date is no more than a year).

**The carrying amount of the LRC is expected to be calculated as the premiums received by brokers/Servicing Carriers (regardless of whether they have been remitted to FA) less any acquisition cash flows.**

**Whether a significant financing component exists was not assessed as FARM policies qualify for the practical expedient.**

## RSP

Under RSP, originating insurers are permitted to transfer whichever policies they would like, provided they meet certain parameters. Once a policy has been identified by the originating insurer as transferred into the applicable RSP, the entire premium must be remitted to the RSP. The amount due from members must be paid by the date shown on the Operational Report (within 21 days) and therefore, the premium received will be recognized on that basis.

As noted within the initial recognition and contract boundary policy paper:

- premiums within the contract boundary of the policies associated with the RSPs are net of the premium payment service charges (i.e. expense allowance) (refer to Initial Recognition and Contract Boundary memo);
- As premiums are net of the expense allowance, there are no insurance acquisition cash flows expected to be incurred for policies associated with the RSP. (Refer to the insurance acquisition cash flow policy paper for more details); and
- Because the financial results of the RSPs are pooled and shared on an accident year basis, each premium ceded will need to be allocated between the relevant accident year.

Similar to FARM, Facility Association did not conclude on whether a significant financing component exists for each group of contracts. This is because regardless of the RSP, the group of contracts would qualify for the practical expedient (i.e. the entity is not required to adjust the carrying amount of the liability for remaining coverage to reflect the time value of money and the effect of financial risk if, at initial recognition, the entity expects that the time between providing each part of the services and the related premium due date is no more than a year).

**The carrying amount of the LRC is expected to be calculated as the premiums received.**

**Whether a significant financing component exists was not assessed as RSPs qualify for the practical expedient.**

## Technical Position

Mechanism	Technical Position
FARM	<p>The carrying amount of the LRC is expected to be calculated as the premiums received by brokers/Servicing Carriers (regardless of whether they have been remitted to FA) less any acquisition cash flows.</p> <p>Whether a significant financing component exists was not assessed as FARM policies qualify for the practical expedient.</p>
RSP	<p>The carrying amount of the LRC is expected to be calculated as the premiums received.</p> <p>Whether a significant financing component exists was not assessed as RSPs qualify for the practical expedient.</p>

**Question 3: How will each group of contracts be subsequently measured?**

***Technical References and Guidance***

**IFRS 17 Standard**

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:
    - 1. any asset for insurance acquisition cash flows applying paragraph 28C; and
    - 2. any other asset or liability previously recognised for cash flows related to the group of contracts as specified in paragraph B66A.
- (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 services provided in that period (see paragraph B126); and
  - (vi) minus any investment component paid or transferred to the liability for incurred claims.

59 In applying the premium allocation approach, an entity:

- (a) may choose to recognise any insurance acquisition cash flows as expenses when it incurs those costs, provided that the coverage period of each contract in the group at initial recognition is no more than one year.
- (b) shall measure the liability for incurred claims for the group of insurance contracts at the fulfilment cash flows relating to incurred claims, applying paragraphs 33–37 and B36–B92. However, the entity is not required to adjust future cash flows for the time value of money and the effect of financial risk if those cash flows are expected to be paid or received in one year or less from the date the claims are incurred.

B126 When an entity applies the premium allocation approach in paragraphs 55–58, insurance revenue for the period is the amount of expected premium receipts (excluding any investment component and adjusted to reflect the time value of money and the effect of financial risk, if applicable, applying paragraph 56) allocated to the period. The entity shall allocate the expected premium receipts to each period of insurance contract services:

- (a) on the basis of the passage of time; but

(b) if the expected pattern of release of risk during the coverage period differs significantly from the passage of time, then on the basis of the expected timing of incurred insurance service expenses.

### **Technical Analysis**

Following the guidance set out above, IFRS 17.55 indicates that at the end of each reporting period, the carrying amount of the LRC consists of the carrying amount at the start of the reporting period:

- a) plus premiums received in the period;
- b) minus insurance acquisition cash flows unless the entity chooses to recognize the payments as an expense applying paragraph 59(a);
- c) plus any amounts relating to the amortization of insurance acquisition cash flows recognized as an expense in the reporting period; unless the entity chooses to recognize insurance acquisition cash flows as an expense applying paragraph 59(a);
- d) plus any adjustment to a financing component, applying paragraph 56;
- e) minus the amount recognized as insurance revenue for services provided in that period (see paragraph B126); and
- f) minus any investment component paid or transferred to the liability for incurred claims.

IFRS 17.B216 indicates that insurance contract revenue for the period is the amount of expected premium receipts allocated to the period. The allocation to each period of insurance contract services is based on the passage of time. However, if the pattern of the release of risk during the coverage period differs significantly from the passage of time, then the expected premium receipts are allocated to periods of coverage on the basis of the expected timing of incurred insurance service expenses. The basis of allocation will be modified if facts and circumstances change over the coverage period.

The liability for incurred claims (LIC) is required to be adjusted for the time value of money and the effect of financial risk if the future cash flows are expected to be paid in more than one year's time from the date the claims are incurred.

An assessment is made below with regards to whether the LIC is required to be adjusted for the time value of money and the effect of financial risk for the policies associated with FARM and the RSP.

### **FARM**

Subsequent to initial recognition, the liability for remaining coverage (LRC) is adjusted as follows:

Adjustment to the LRC	Analysis
Opening balance	
+ premiums received in the period	Premiums received = premiums received by brokers/Servicing Carriers, regardless of whether they have been remitted to FA
- insurance acquisition cash flows unless the entity chooses to recognize the payments as an expense applying paragraph 59(a);	Insurance acquisition cash flows will be deferred and amortized (refer to insurance acquisition cash flows paper for additional detail re: the population of

	insurance acquisition cash flows)
+ any amounts relating to the amortization of insurance acquisition cash flows recognized as an expense in the reporting period; unless the entity chooses to recognize insurance acquisition cash flows as an expense applying paragraph 59(a);	Insurance acquisition cash flows will be amortized in a pattern consistent with insurance revenue
+ any adjustment to a financing component, applying paragraph 56;	N/A as FARM policies qualify for the practical expedient.
- the amount recognized as insurance revenue for services provided in that period (see paragraph B126); and	Insurance revenue will be recognized in accordance with passage of time
- any investment component paid or transferred to the liability for incurred claims.	N/A as none have been identified.

For FARM policies, the settlement of claims is expected to occur in greater than one year's time from the date the claims are incurred based on the historical settlement of claims. Therefore, the liability for incurred claims is expected to be adjusted for the time value of money and the effect of financial risks.

**See table above.**

**The LIC is expected to be adjusted for the time value of money and the effect of financial risks as the settlement of claims is likely to occur in greater than one year's time from the date claims are incurred.**

## RSP

Subsequent to initial recognition, the liability for remaining coverage (LRC) is adjusted as follows:

Adjustment to the LRC	Analysis
Opening balance	
+ premiums received in the period	Premiums received by the RSPs <sup>2</sup>
- insurance acquisition cash flows unless the entity chooses to recognize the payments as an expense applying paragraph 59(a);	N/A as no insurance acquisition cash flows were identified.
+ any amounts relating to the amortization of insurance acquisition cash flows recognized as an expense in the reporting period; unless the entity chooses to recognize insurance acquisition cash flows as an expense applying paragraph 59(a);	N/A as no insurance acquisition cash flows were identified.
+ any adjustment to a financing component, applying paragraph 56;	N/A as RSPs qualify for the practical expedient.
- the amount recognized as insurance revenue for services provided in that period (see paragraph B126); and	Insurance revenue will be recognized in accordance with passage of time
- any investment component paid or transferred to the liability for incurred claims.	N/A as none have been identified.

For RSPs, the settlement of claims is expected to occur in greater than one year's time from the date the claims are incurred based on the historical settlement of claims. Therefore, the liability for incurred claims is expected to be adjusted for the time value of money and the effect of financial risks.

**See table above.**

**The LIC is expected to be adjusted for the time value of money and the effect of financial risks as the settlement of claims is likely to occur in greater than one year's time from the date claims are incurred.**

<sup>2</sup> For the purpose of the RSPs, the premiums received will be calculated as being the premiums written from the previous month as cash from amounts receivable is generally collected within 14 days from the date it is due.

**Technical Position**

Mechanism	Technical Position
FARM	<p>See table above for detailed analysis</p> <p>Insurance contract revenue will be allocated to each period based on the passage of time</p> <p>The LIC is expected to be adjusted for the time value of money and the effect of financial risks as the settlement of claims is likely to occur in greater than one year's time from the date claims are incurred.</p>
RSP	<p>See table above for detailed analysis</p> <p>Insurance contract revenue will be allocated to each period based on the passage of time</p> <p>The LIC is expected to be adjusted for the time value of money and the effect of financial risks as the settlement of claims is likely to occur in greater than one year's time from the date claims are incurred.</p>



**Question 4: How will each group of contracts be assessed to be onerous?**

***Technical References and Guidance***

**IFRS 17 Standard**

- 18 For contracts issued to which an entity applies the premium allocation approach (see paragraphs 53–59), the entity shall assume no contracts in the portfolio are onerous at initial recognition, unless facts and circumstances indicate otherwise. An entity shall assess whether contracts that are not onerous at initial recognition have no significant possibility of becoming onerous subsequently by assessing the likelihood of changes in applicable facts and circumstances.
- 57 If at any time during the coverage period, facts and circumstances indicate that a group of insurance contracts is onerous, an entity shall calculate the difference between: (a) the carrying amount of the liability for remaining coverage determined applying paragraph 55; and (b) the fulfilment cash flows that relate to remaining coverage of the group, applying paragraphs 33–37 and B36–B92. However, if, in applying paragraph 59(b), the entity does not adjust the liability for incurred claims for the time value of money and the effect of financial risk, it shall not include in the fulfilment cash flows any such adjustment.
- 58 To the extent that the fulfilment cash flows described in paragraph 57(b) exceed the carrying amount described in paragraph 57(a), the entity shall recognise a loss in profit or loss and increase the liability for remaining coverage.

**Technical Analysis**

For contracts that apply the PAA it is assumed that no contracts in the portfolio are onerous on initial recognition, unless facts and circumstances indicate otherwise and the assessment of whether contracts have no significant possibility of becoming onerous subsequently is performed by assessing the likelihood of changes in applicable facts and circumstances.

Following the guidance set out above, IFRS 17.57 indicates that if facts and circumstances indicate the group of insurance contracts is onerous at any time during the coverage period, the difference between the following will need to be calculated:

- a) the carrying amount of the liability for remaining coverage determined applying paragraph 55; and
- b) the fulfilment cash flows that relate to remaining coverage of the group, applying paragraphs 33–37 and B36–B92.

The fulfilment cash flows noted in (b) above will include any adjustments in relation to the time value of money and the effect of financial risk as the liability for incurred claims is adjusted for those items (see conclusion noted above).

To the extent the fulfilment cash flows described in (b) above exceed the carrying amount described in (a) above, a loss shall be recognized in profit or loss and the LRC shall be increased for this amount. This loss recognized represents the loss component.

For policies associated with FARM and the RSP, the loss component will be subsequently measured by:

- 1. Performing the calculations noted above in the subsequent measurement section associated with IFRS 17.57-58 to determine the loss component at the end of each reporting period;

2. Calculating the difference between the loss component balance from the beginning of the reporting period and the loss component calculated applying (1) above; and
3. The difference calculated in (2) above will be the subsequent measurement adjustment (i.e. reversal) to the loss component in each reporting period.

When performing step (1) above and calculating the carrying amount of the LRC applying IFRS 17.55, the requirements have been interpreted to refer to a calculation of the carrying amount of the LRC using IFRS 17.55(b) excluding the previously recognized loss component.

The initial recognition of the PAA loss component and its subsequent reversals will be presented through insurance service expenses.

## **FARM**

When assessing the ‘facts and circumstances’ to determine if the group of contracts may be onerous:

Prior to recognition of a group of contracts, FA will consider:

- The expectation of a fulfilment ratio greater than 100%;
- Previous cohorts and whether they:
  - Had fulfilment ratios greater than 100%; or
  - Were onerous (at initial recognition or subsequently)

In addition, on a quarterly basis, FA will consider:

- Current expectations of fulfilment ratios;
- Unfavorable experience trends;
- Unfavorable external or other conditions.

## **RSP**

The Facility Association designed the RSPs to promote stability in the marketplace by making it possible for companies to accept risks for which they believe that their prices are not totally adequate. Therefore, the general expectation is that RSPs, by their very nature, will operate on an overall basis at a financial loss.

Other than the nature of the RSPs, an indication of onerousness for RSP policies could be the cumulative deficit in previous years in the RSPs’ financial statements.

Therefore, the RSP will assume that the facts and circumstances indicate the policies associated with the RSP are onerous at initial recognition.

Prior to recognition of a group of contracts, FA will consider:

- The expectation of a fulfilment ratio greater than 100%;
- Previous cohorts and whether they:
  - Had fulfilment ratios greater than 100%; or
  - Were onerous (at initial recognition or subsequently)

In addition, on a quarterly basis, FA will consider:

- Current expectations of fulfilment ratios;
- Unfavorable experience trends;
- Unfavorable external or other conditions.

**As the general expectation is that the RSPs will operate on an overall basis at a financial loss, policies associated with the RSPs will be assumed to have the facts and circumstances indicate onerousness at initial recognition.**

### Technical Position

Mechanism	Technical Position
FARM	<p>Prior to recognition of a group of contracts, FA will consider (refer to Level of Aggregation memo):</p> <ul style="list-style-type: none"> <li>• The expectation of a fulfilment ratio greater than 100%;</li> <li>• Previous cohorts and whether they: <ul style="list-style-type: none"> <li>○ Had fulfilment ratios greater than 100%; or</li> <li>○ Were onerous (at initial recognition or subsequently)</li> </ul> </li> </ul> <p>In addition, on a quarterly basis, FA will consider:</p> <ul style="list-style-type: none"> <li>• Current expectations of fulfilment ratios;</li> <li>• Unfavorable experience trends;</li> <li>• Unfavorable external or other conditions.</li> </ul>
RSP	<p>Prior to recognition of a group of contracts, FA will consider (refer to Level of Aggregation memo):</p> <ul style="list-style-type: none"> <li>• The expectation of a fulfilment ratio greater than 100%;</li> <li>• Previous cohorts and whether they: <ul style="list-style-type: none"> <li>○ Had fulfilment ratios greater than 100%; or</li> <li>○ Were onerous (at initial recognition or subsequently)</li> </ul> </li> </ul> <p>In addition, on a quarterly basis, FA will consider:</p> <ul style="list-style-type: none"> <li>• Current expectations of fulfilment ratios;</li> <li>• Unfavorable experience trends;</li> <li>• Unfavorable external or other conditions.</li> </ul> <p>As the general expectation is that the risk sharing pools will operate on an overall basis at a financial loss, policies associated with the RSP will be assumed to have the facts and circumstances indicate onerousness at initial recognition.</p>