

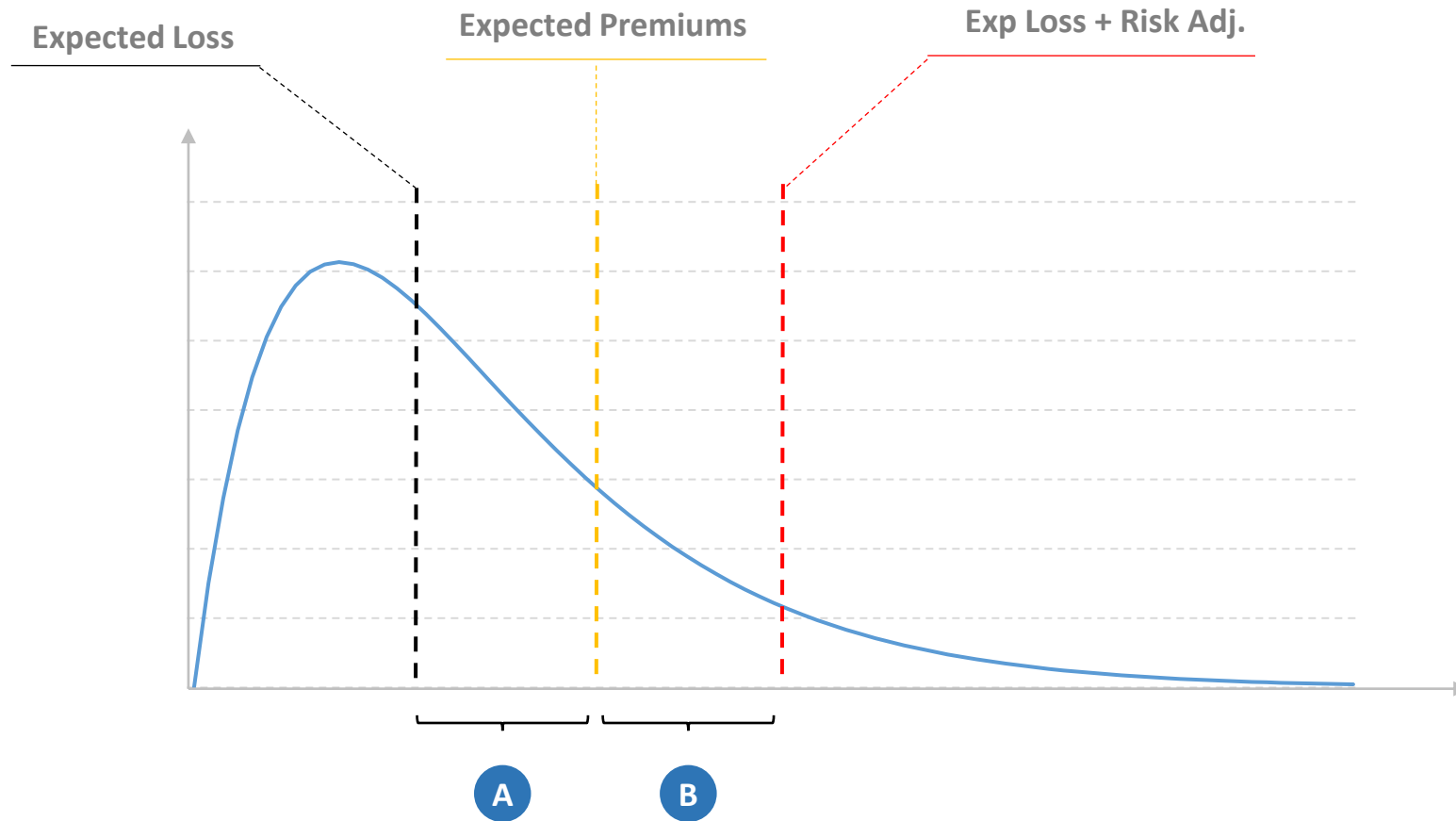
Onerous Contracts



Introduction to IFRS 17

Onerous contract concept

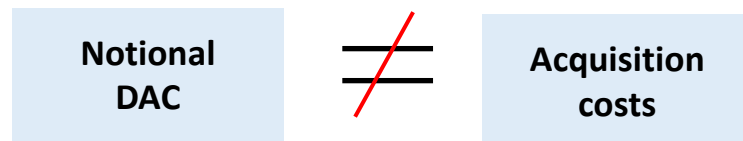
Example of a profitable insurance contract that, at the same time, is onerous under IFRS 17



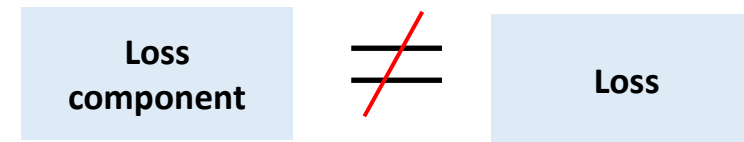
A Contract is profitable because the expected losses are lower than the expected premiums.

B Contract is onerous because the expected losses plus risk adj. are higher than expected premiums.

The difference between the loss component and loss is similar to the difference between the notional DAC and acquisition cost.



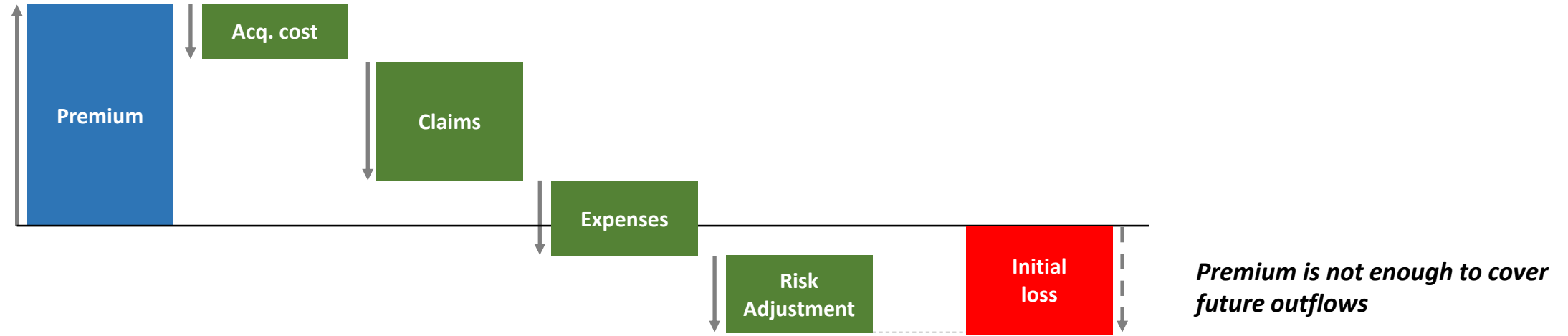
- Notional DAC represent the portion of acquisition costs that have not been recognised in the P&L yet.
- Amortisation of the Notional DAC does not have any impact on the results (the same amount recognised in revenue and costs).
- Notional DAC amortisation pattern should be based on the passage of time.



- Loss component represents the portion of the loss that has not been recognised in the P&L yet.
- Amortisation of the loss component does not have any impact on the results (the same amount deducted from revenue and costs).
- Amortisation of the Loss component is driven by the run-off of claims, expenses and risk adjustment.

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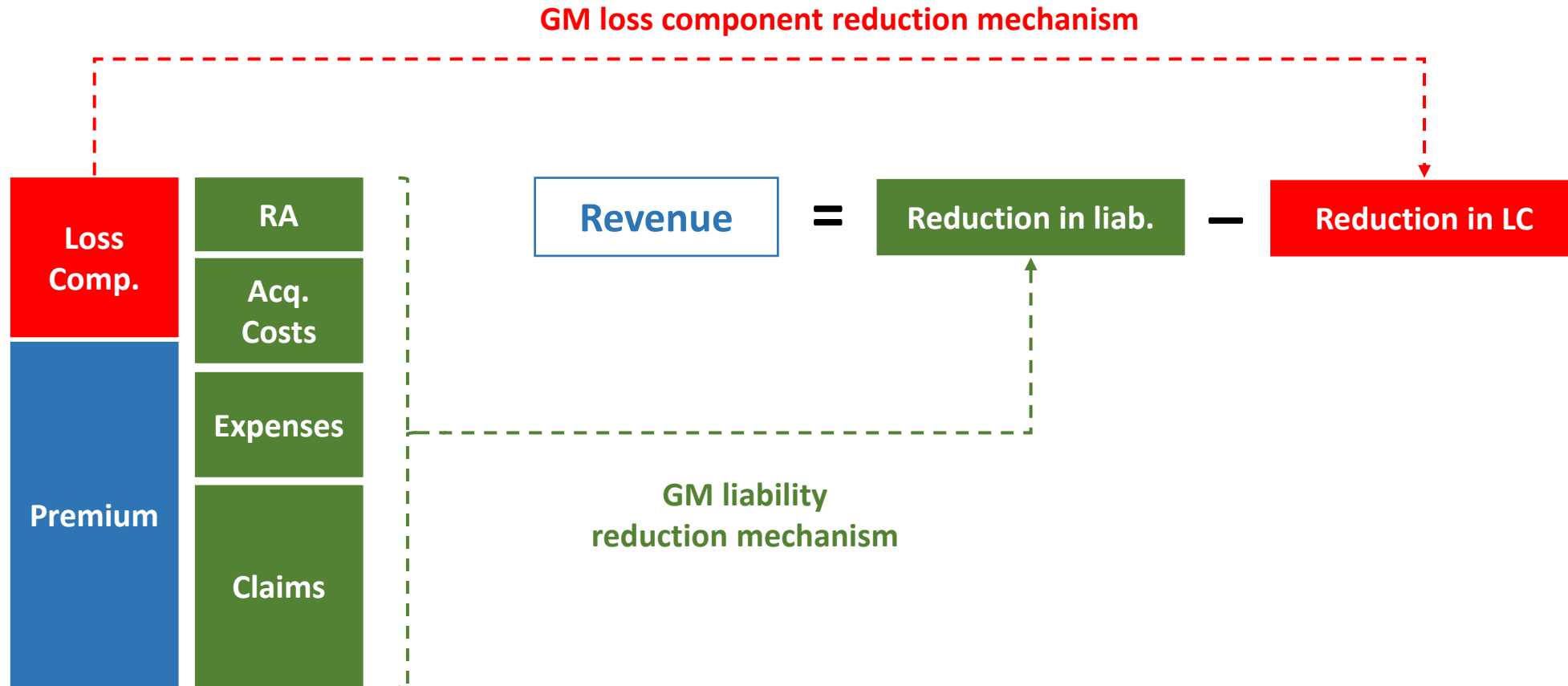
Loss component - Initial measurement



Present value of future inflows – 5,000
Present value of future outflows – 7,500

Day one result – loss of 2,500

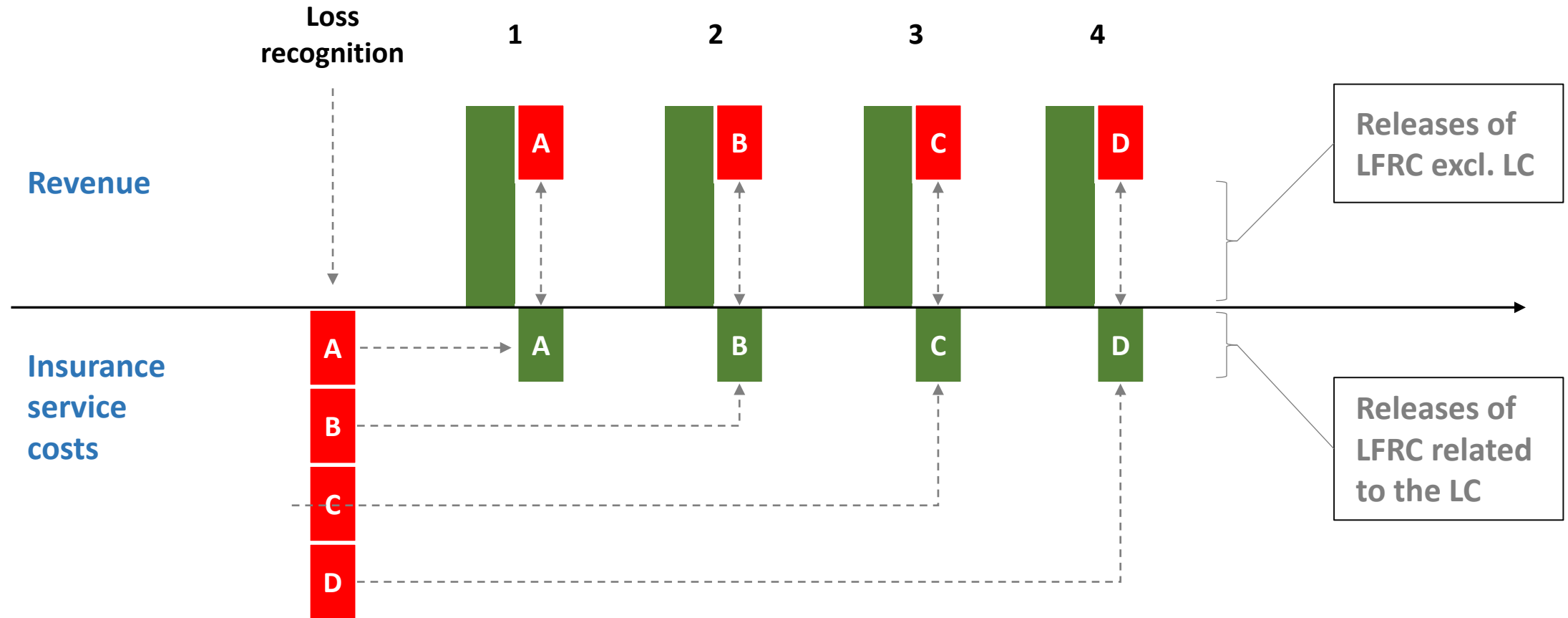
Revenue under the GM



PAA Loss Component

GM loss component [2]

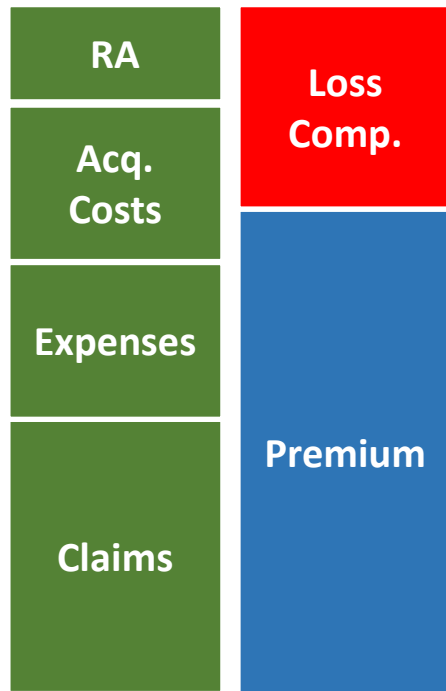
Loss component under the GM



PAA Loss Component

PAA loss component

Revenue under the PAA



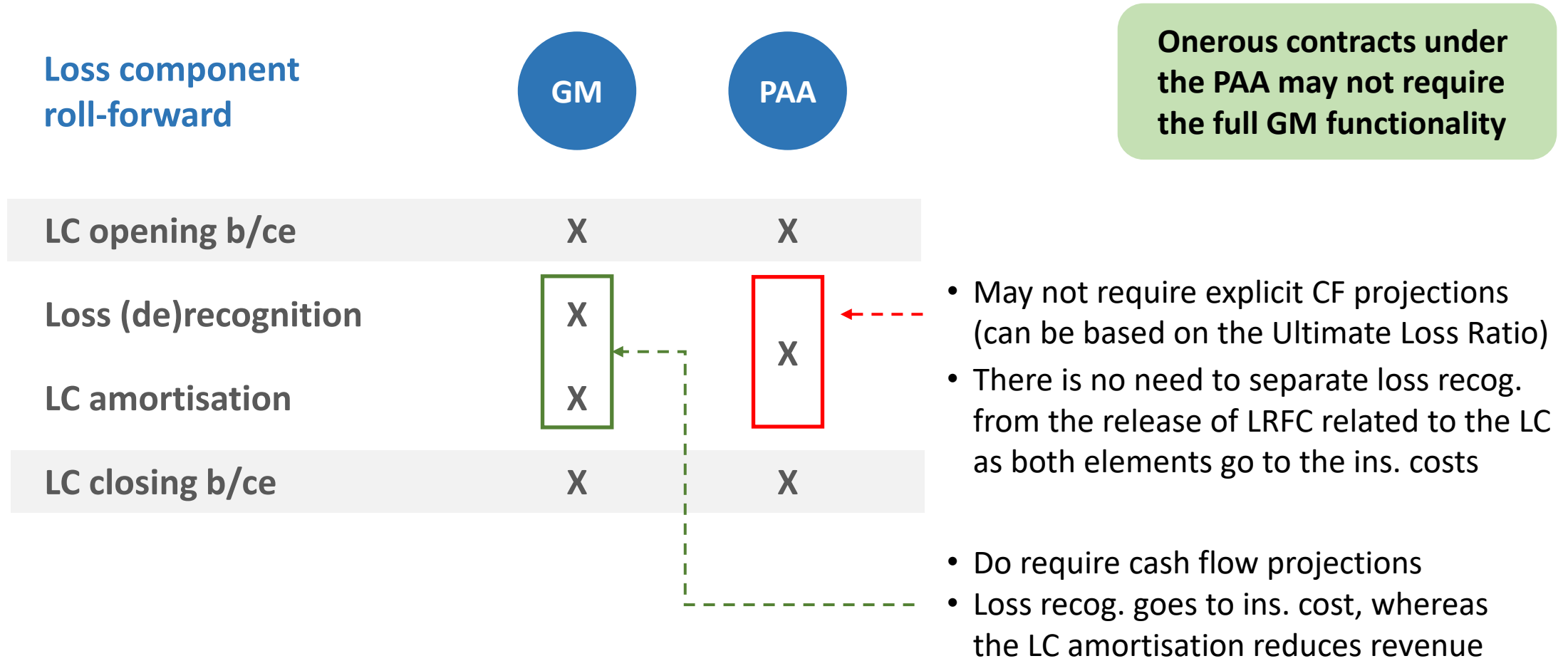
$$\text{Revenue} = \text{Portion of premiums}$$



- 1 No GM liability reduction mechanism required
- 2 No GM LC reduction mechanism required

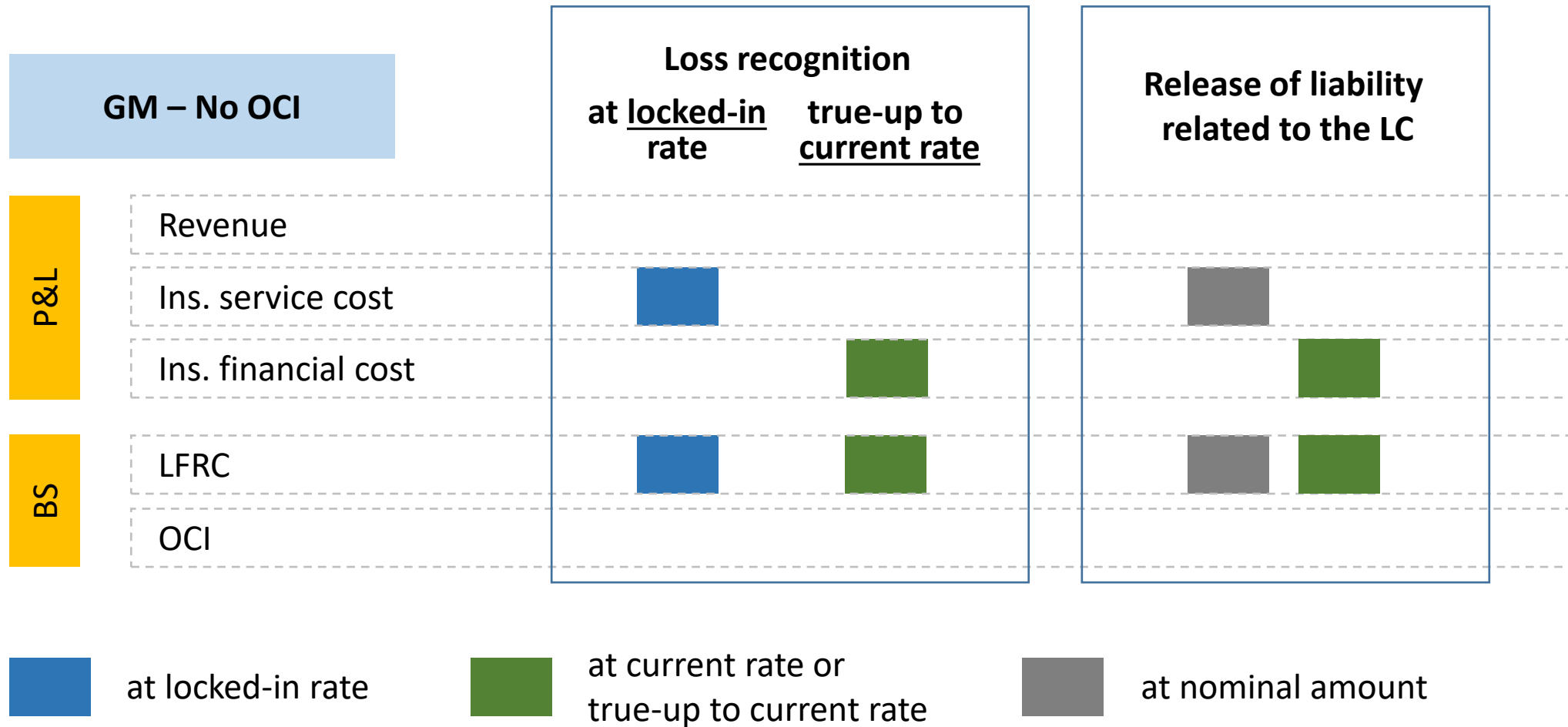
PAA Loss Component

PAA vs GM loss component



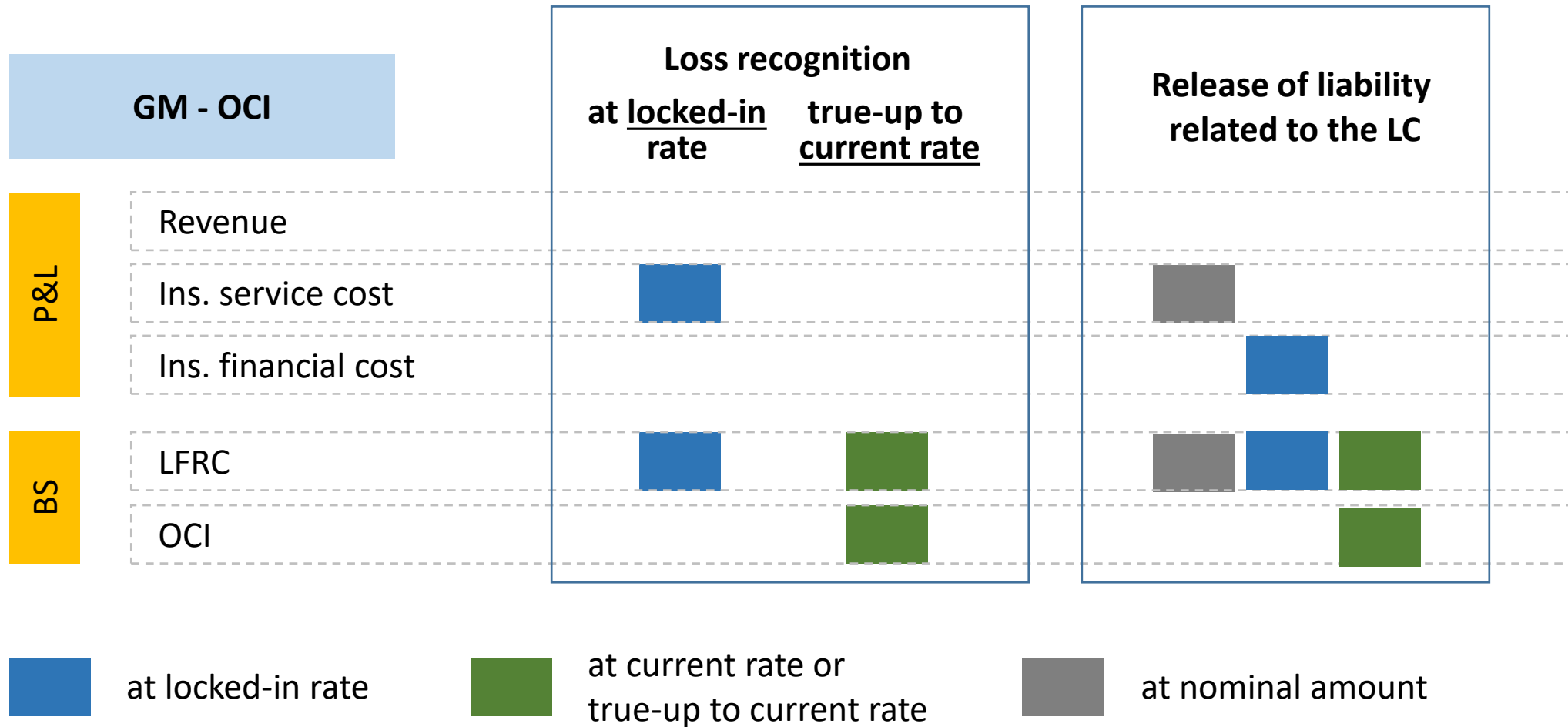
PAA Loss Component

Loss component accounting - GM - No OCI



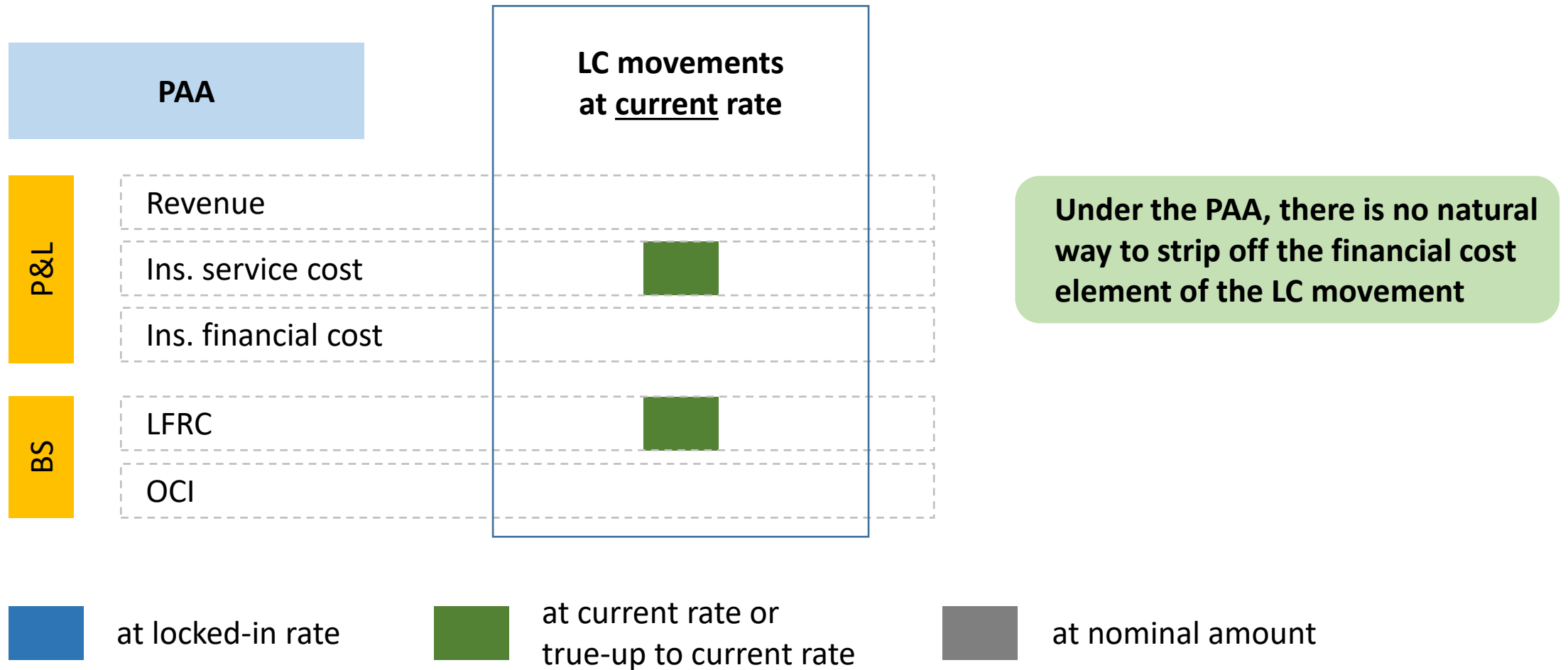
PAA Loss Component

Loss component accounting - GM - OCI



PAA Loss Component

Loss component accounting - PAA



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Appendix I - Loss component - Example [1]

- 3-year insurance
- Premiums - 70 per year, paid at the beginning of the year
- Claims - 40 per year, paid at the end of the year
- Expenses - 10 per year, paid at the end of the year
- Acquisition costs - 90, paid at inception
- Recognised evenly over the insurance period
- CERA movement allocated to the LC in proportion to LC/CERA at the beginning of the year
- No experience variances
- No changes in estimates in the first version of the example
- Claims and expenses estimates for the year 3 changed
From 50 (40+10) to 10 (5+5) in the second version of the example
- Risk margin ignored
- Discounting ignored
- Credit (liabilities and incomes) shown with minus
- Debits (assets and expenses) shown with plus

Cash flows	0	1	2	3	Total
Premiums	70.0	70.0	70.0	-	210.0
Claims	-	(40.0)	(40.0)	(40.0)	(120.0)
Expenses	-	(10.0)	(10.0)	(10.0)	(30.0)
Acq. Costs	(90.0)	-	-	-	(90.0)
Total	(20.0)	20.0	20.0	(50.0)	(30.0)

Initial accounting	FCF	CSM	Bank	P&L
Initial premium	-	(70.0)	70.0	-
Future premiums	140.0	(140.0)	-	-
Claims	(120.0)	120.0	-	-
Expenses	(30.0)	30.0	-	-
Acq. Costs	-	90.0	(90.0)	-
Initial loss	-	(30.0)	-	30.0
Total	(10.0)	0.0	(20.0)	30.0

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Appendix I - Loss component - Example [2]

Loss component	0	1	2	3
LC	(30.0)	(20.0)	(10.0)	-
CSM	-	-	-	-
CERA	(150.0)	(100.0)	(50.0)	-
LC/CERA	20.0%	20.0%	20.0%	-

First version of the example

No changes in estimates

Income statement	1	2	3	Total	
Claims	(32.0)	(32.0)	(32.0)	(96.0)	Claims x (1-LC/CERA)
Expenses	(8.0)	(8.0)	(8.0)	(24.0)	Expenses x (1-LC/CERA)
Acq. Cost	(30.0)	(30.0)	(30.0)	(90.0)	Acq. Costs/3
CSM amortisation	-	-	-	-	
Revenue	(70.0)	(70.0)	(70.0)	(210.0)	
Claims	40.0	40.0	40.0	120.0	
Expenses	10.0	10.0	10.0	30.0	
Acq. Cost	30.0	30.0	30.0	90.0	
Initial loss	30.0	-	-	30.0	
Reversal of losses	(10.0)	(10.0)	(10.0)	(30.0)	(Claims+Expenses) x LC/CERA
Insurance service cost	100.0	70.0	70.0	240.0	
Result	30.0	-	-	30.0	

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Appendix I - Loss component - Example [3]

Loss component	0	1	2	3
LC	(30.0)	(20.0)	-	-
CSM	-	-	30.0	-
CERA	(150.0)	(100.0)	(50.0)	-
LC/CERA	20.0%	20.0%	-	-

Income statement	1	2	3	Total
Claims	(32.0)	(32.0)	(5.0)	(69.0)
Expenses	(8.0)	(8.0)	(5.0)	(21.0)
Acq. Cost	(30.0)	(30.0)	(30.0)	(90.0)
CSM amortisation	-	-	(30.0)	(30.0)
Revenue	(70.0)	(70.0)	(70.0)	(210.0)
Claims	40.0	40.0	5.0	85.0
Expenses	10.0	10.0	5.0	25.0
Acq. Cost	30.0	30.0	30.0	90.0
Initial loss	30.0	-	-	30.0
Reversal of losses	(10.0)	(20.0)	-	(30.0)
Insurance service cost	100.0	60.0	40.0	200.0
Result	30.0	(10.0)	(30.0)	(10.0)

Second version of the example

Claims and expenses estimate for the year 3 changed from 50 (40+10) to 10 (5+5)

Impacted elements market in yellow

As a result of the positive estimate variance of 40, the remaining LC has been reduced to 0 and the CSM of 30 has been set up