

APN112/405

Advisory Practice Note 112/405

IFRS 17 Insurance Contracts

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## Introduction

This Advisory Practice Note (APN) provides guidance to [actuaries](#) when performing [actuarial services](#) in connection with [International Financial Reporting Standard 17](#) Insurance Contracts ([IFRS 17](#)) issued in May 2017.

IFRS 17 Insurance Contracts establishes principles for the recognition, measurement, presentation and disclosure of [insurance contracts](#) and [reinsurance contracts](#). The objective is to ensure that [entities](#) provide relevant information in a way that faithfully represents those contracts.

An [entity](#) which reports financial statements under [IFRS](#) is responsible for the information reported. This means it is responsible for, amongst other things, identification, combination, aggregation, separation, recognition and derecognition of contracts, the choice of measurement approach and assumptions, the measurement calculations and the disclosures in the [IFRS](#) financial statements.

Nevertheless, [actuaries](#) providing [actuarial services](#) in connection with [IFRS 17](#) may be advising the [entity](#) on decisions, carrying out the calculations required or some combination of these.

**As recommended by the International Actuarial Association (the IAA), this Advisory Practice Note is a model standard of actuarial practice and, as such, is not binding on any actuary. For this reason, this guidance is classified under the guidance naming convention of ASSA, as Advisory Practice Note 112/405 (APN112/405), rather than as a Standard of Actuarial Practice (SAP).** The [IAA \(and by extension, the Actuarial Society of South Africa\)](#) intends this APN to:

- Facilitate convergence in standards of actuarial practice in connection with [IFRS 17](#);
- Increase public confidence in [actuarial services](#) provided in connection with [IFRS 17](#); and
- Demonstrate the [IAA](#)'s (and ASSA's) commitment to support the work of the International Accounting Standards Board (IASB) in achieving high quality, transparent and comparable financial reporting internationally, as envisaged by the Memorandum of Understanding between the [IAA](#) and the IASB.

## Section 1. General

- 1.1. Purpose** – This APN provides guidance to [actuaries](#) when performing [actuarial services](#) in connection with [IFRS 17](#). Its purpose is to increase [intended users](#)' confidence that:
- [Actuarial services](#) are carried out professionally and with due care;
  - The results are relevant to their needs, are presented clearly and understandably, and are complete; and
  - The assumptions and methodology (including [models](#) and modelling techniques) used are disclosed appropriately.
- 1.2. Scope** – This APN applies to [actuaries](#) when performing [actuarial services](#) related to [IFRS 17](#) for the preparation of an [entity](#)'s actual or pro-forma [IFRS](#) financial statements. [Actuaries](#) performing other [actuarial services](#) in connection with [IFRS 17](#) (for example: an [actuary](#) advising a third party such as an auditor or a regulator, or advising a potential buyer regarding an acquisition) should apply the guidance in this APN to the extent relevant to the assignment.
- Wherever in this guidance reference is made to an actuary's disclosure in a report, this should not be interpreted as to imply that formal reporting is necessarily required by the actuary. However, it does apply where and when formal reporting on the relevant matters pertaining to the IFRS 17 Standard by the actuary is required in performing his / her duties in the context of IFRS 17.**
- 1.3. Relationship to APN901** – Compliance with APN901 (General Actuarial Practice) is a prerequisite to compliance with this APN.
- 1.4. Relationship to IFRSs** – This APN relates to the content of [IFRS 17](#) and other relevant [IFRSs](#), including any interpretations from the International Financial Reporting Interpretations Committee (IFRIC) or its predecessor, the Standing Interpretations Committee, as issued through 16 August 2019. The guidance in this APN complements the guidance in [IFRS 17](#), which is not repeated in this APN.
- 1.5. Defined Terms** – This APN uses various terms whose specific meanings are defined in the Glossary. These terms are highlighted in the text with a dashed underscore and in blue, which is a hyperlink to the definition (e.g., [actuary](#)).
- This APN also uses key terms from [IFRS 17](#), in which case they have the meaning as used in [IFRS 17](#). These terms are highlighted in the text with a double underscore and in green (e.g., [insurance contract](#)).
- 1.6. Cross References** – If [IFRS 17](#), or any other [IFRS](#) referenced in this APN, is subsequently amended, restated, revoked or replaced by the IASB, or interpreted by IFRIC after 16 August 2019, the [actuary](#) should consider the extent to which guidance in this APN is still applicable and appropriate.
- 1.7. Effective Date** – This APN is effective for {[actuarial services](#) performed/[actuarial services](#) commenced/[actuarial services](#) performed with respect to [IFRS](#) financial statements for a reporting period ending on or after the date that this guidance as become effective.

## Section 2. Appropriate Practices

- 2.1. Relevant Knowledge Requirements** – In applying [APN 901](#) paragraph 2.2.<sup>1</sup>, the [actuary](#) should have or obtain sufficient knowledge and understanding of information necessary to perform the assignment, such as:
- a. [IFRS 17](#), applicable sections of other relevant [IFRSs](#) (e.g., IFRS 13 when measuring Fair Value), the [entity](#)'s [accounting policies](#) and the relevant processes that are applied in the preparation of [IFRS](#) financial statements;
  - b. The business environment in which the entity operates, including the financial market(s) from which it obtains [data](#);
  - c. The [entity](#)'s appetite for risks that have an impact on the measurement under [IFRS 17](#);
  - d. The [entity](#)'s products and operations;
  - e. The methodologies and assumptions used by the [entity](#) in other relevant contexts and the rationale for any differences;
  - f. How [law](#) affects the application of [IFRS 17](#); and
  - g. The relevant auditing standards.
- 2.2. Materiality** – The [actuary](#) should understand the distinction between materiality with respect to the [actuarial services](#), the preparation of [IFRS](#) financial statements and the auditing of those financial statements.
- 2.2.1. When appropriate for the [work](#), the [actuary](#) should seek guidance from the [principal](#) or the [entity](#) regarding materiality.
  - 2.2.2. In applying [APN 901](#) paragraph 2.4.<sup>2</sup>, with respect to the preparation of [IFRS](#) financial statements the [actuary](#)'s threshold of materiality with respect to the [actuarial services](#) should not be greater than the [entity](#)'s threshold of materiality.
  - 2.2.3. In all following paragraphs of this APN, any use of “material” or “materiality” is with respect to the [actuarial services](#) carried out in accordance with this APN.
- 2.3. Proportionality** – In applying [APN 901](#) paragraph 1.4.<sup>3</sup>, and in particular paragraph 1.4.2., the [actuary](#) should take into account materiality. In addition, the degree of refinement in specific assumptions or methods recommended by the [actuary](#) should be proportionate to their possible impact on the results of the [actuarial services](#).
- 2.4. Identification, Combination, Aggregation, Separation, Recognition, Derecognition and Modification** – The [actuary](#) should treat the processes of:
- a. Identification of [insurance contracts](#);
  - b. Combination of [insurance contracts](#);

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<sup>1</sup> Knowledge of Relevant Circumstances

<sup>2</sup> Materiality

<sup>3</sup> Reasonable Judgment

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- c. Determination of the level of aggregation (refer to 2.6.14.);
  - d. Separation of components from an [insurance contract](#) for treatment under a different standard;
  - e. Separation of components of an [insurance contract](#) for different treatment under [IFRS 17](#) (if and to the extent permitted);
  - f. Recognition of groups of contracts and derecognition of [insurance contracts](#); and
  - g. Treatment of [insurance contract](#) modifications
- as being subject to [APN 901](#) paragraph 2.7.<sup>4</sup> or 2.8.<sup>5</sup>.

The [actuary](#) should disclose in the [report](#) changes in the above processes, including the rationale for and impact of the changes.

- 2.5. Measurement Approach** – The [actuary](#) should treat the processes of selecting the appropriate measurement approach to be applied to each [group of insurance contracts](#), whether it is the [general measurement approach](#), the [premium allocation approach \(PAA\)](#) or the [variable fee approach](#), as being subject to [APN 901](#) paragraph 2.7.<sup>4</sup> or 2.8.<sup>5</sup>.

The [actuary](#) should disclose in the [report](#) changes in the above processes, including the rationale for and impact of the changes.

### 2.6. The General Measurement Approach

- 2.6.1. [General Approach for Selection of Assumptions](#) – In applying [APN 901](#) paragraph 2.7.<sup>4</sup>, when advising the [principal](#) or the [entity](#) on actuarial assumptions, the [actuary](#) should consider matters such as:
- a. Combining similar risks based on the nature of the insurance obligation, without being constrained by the actual grouping of [insurance contracts](#) that is used for measurement purposes;
  - b. Whether assumptions developed in other contexts, for example pricing assumptions, may be inappropriate for [IFRS 17](#) purposes;
  - c. Links as necessary to ensure consistency between assumptions (e.g., assumptions related to option exercise patterns should be linked to the economic scenarios);
  - d. The potential asymmetrical distribution of the current estimates (e.g., assumptions to deal with extreme events like tail events or options and guarantees that are triggered by market conditions);
  - e. The credibility of [data](#) when combining information from various sources or time periods; and

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<sup>4</sup> Assumptions and Methodology Set by Actuary

<sup>5</sup> Assumptions and Methodology Prescribed (other than by Law)

- f. Long-term trends and seasonal variations, and other changes in the environment (e.g., applicable [law](#), economic, demographic, technological and social).
- 2.6.2. Process for Updating Assumptions – If the [actuary](#) considers it appropriate to change the process, including the methodology, used to update a recommended assumption, the [actuary](#) should discuss the change with the [principal](#), including whether it would constitute a change in [accounting policy](#) or just a change in an accounting estimate as defined in International Accounting Standard 8 (IAS 8) *Accounting Policies, Changes in Accounting Estimates and Errors*.
- The [actuary](#) should disclose in the [report](#) changes in such processes, including the rationale for and impact of the changes.
- 2.6.3. Insurance Risk – When advising the [principal](#) or the [entity](#) on assumptions to measure [insurance risk](#), the [actuary](#) should consider factors including the following:
- Characteristics of the [insurance contract](#) including the risks being insured;
  - Characteristics of the policyholder and the way the contract was sold;
  - Past experience of incurred claims including patterns of delays in reporting and payment and the relevance to expected future experience; and
  - Practices of the [entity](#), such as underwriting procedures and claims management.
- 2.6.4. Policyholder Options – When advising the [principal](#) or the [entity](#) on assumptions for the exercise of options by policyholders, the [actuary](#) should consider factors such as the following:
- Past experience of how policyholders have exercised options;
  - Likely behaviour of policyholders, taking into account factors such as [anti-selection](#), the effects of non-financial considerations, and the relative advantages to the policyholder of exercising any options;
  - Characteristics of how the [insurance contracts](#) are sold and serviced;
  - Significant scheduled changes in premiums, charges, benefits or terms and conditions; and
  - Any short-term spikes in cancellation rates created by the exercise of certain options.
- 2.6.5. Entity Discretion – When advising the [principal](#) or the [entity](#) on assumptions which consider the exercise of discretion by the [entity](#), the [actuary](#) should take into account expectations or limitations that may arise from sources such as:
- The [entity](#)'s marketing and promotional materials;
  - The [entity](#)'s past practices;
  - The [entity](#)'s current policy;
  - Market practices; and
  - [Laws](#) and rulings of relevant authorities.

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- 2.6.6. Reinsurance Contracts Held – When advising the principal or the entity, on the measurement of reinsurance contracts held, the actuary should:
- a. When estimating amounts recoverable under multiple reinsurance arrangements, consider the order in which the reinsurance contracts apply;
  - b. When estimating non-recoverable amounts:
    - i. Consider the financial condition of the reinsurer, the existence of collateral and the extent to which default by one reinsurer may affect the amounts recoverable from other reinsurers; and
    - ii. In the estimates of future cash flows to be received from reinsurance contracts, allow for the uncertainty caused by the potential of non-performance by reinsurers;
  - c. When estimating fulfilment cash flows, consider the extent to which each reinsurance counterparty exercises its control over recapture, cancellation or commutation to its advantage; and
  - d. Consider the impact of reinstatement of reinsurance contracts following claims.
- 2.6.7. Reinsurance Contracts Issued – When advising the principal or the entity, on the measurement of reinsurance contracts issued, the actuary should consider circumstances such as:
- a. The expected behaviour with respect to the available options of the policyholders, the issuer of the underlying insurance contracts and all intermediate reinsurers;
  - b. The underwriting and management practices, including the underwriting for facultative placements, and the claim management processes impacting the reinsurance contracts issued;
  - c. Reinstatement of reinsurance contracts following claims; and
  - d. Default by the issuer of the underlying insurance contracts and all intermediate reinsurers.
- 2.6.8. Currency Exchange – When advising the principal or the entity on the estimation of the fulfilment cash flows in multiple currencies, the actuary should reflect current market expectations of future currency exchange rates.
- 2.6.9. Discount Rates – When advising the principal or the entity on the derivation of:
- a. Discount rates for periods beyond those for which observable data from an active market are available, the actuary should consider how current rates are expected to evolve over time using the best information available in the circumstances, including such market prices as are observable;
  - b. Discount rates for cash flows of insurance contracts, that vary with the returns of the entity's invested assets, the actuary should consider the entity's investment policy, as applied in practice, taking into account the entity's communications to various stakeholders and, where applicable, anticipated policyholder behaviour;

- c. Illiquidity and credit or default adjustments for determining the discount rates, the [actuary](#) should consider:
    - i. Approaches that are robust and that should be able to be applied reliably over time and under a variety of market conditions, to reflect the illiquidity of the cashflows underlying the relevant liabilities; and
    - ii. The possible methods for calculating such adjustments to observed market rates. Methods include market-based techniques, structural model techniques and expected / unexpected credit loss techniques.
- 2.6.10. Contracts with Cash Flows that Vary with Returns on Underlying Items - When advising the [principal](#) or the [entity](#) on contracts whose cash flows vary with returns on [underlying items](#), the [actuary](#) should:
- a. Select discount rates used to calculate the present value of the cash flows to measure the [fulfilment cash flows](#) that are consistent with the investment returns anticipated in the estimates of the future cash flows. Returns on assets should be estimated using prospective expectations consistent with current market expectations of future economic conditions; and
  - b. For cash flows which are subject to a floor or a cap, consider the associated impact, if any, on the estimates of future cash flows, the [risk adjustment for non-financial risk](#) and the discount rates in the projection.
- 2.6.11. Maintenance Expenses – When advising the [principal](#) or the [entity](#) on the estimation of cash flows for maintenance expenses such as policy administration and claim handling costs, and attributable overheads, the [actuary](#) should consider factors such as:
- a. The [entity](#)'s cost-accounting and expense allocation policies;
  - b. Expenses expected to arise from fulfilling insurance obligations existing on the [measurement date](#). This estimate should consider factors such as the [entity](#)'s past experience and current business plans, and the impact of future inflation; and
  - c. Terms of any outsourcing arrangements.
- 2.6.12. Insurance Acquisition Cash Flows – The [actuary](#) should be satisfied that the allocation of [insurance acquisition cash flows](#) to each [portfolio of insurance contracts](#) is made on a consistent basis.
- 2.6.13. Risk Adjustment for Non-Financial Risk – When advising the [principal](#) or the [entity](#) on the [risk adjustment for non-financial risk](#), the [actuary](#) should:
- a. Understand the [non-financial risk](#) inherent in the [insurance contracts](#);
  - b. In assessing what the [entity](#) requires as compensation for bearing the [non-financial risk](#):
    - i. Reflect the diversification benefit that the [entity](#) recognizes at the relevant level of consolidation; and
    - ii. Consider sources of relevant information, such as the [entity](#)'s capital management, risk management and pricing policies.

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- c. Select a methodology that, at the chosen level of aggregation:
  - i. Uses assumptions that are consistent with those used in the determination of the corresponding estimates of future cash flows;
  - ii. Reflects the risk differences between the [portfolios of insurance contracts](#); and
  - iii. Allows for the diversification that the [entity](#) recognizes.
- d. Make appropriate allowance for mechanisms that result in risk being passed to the policyholder (e.g., contracts with participation or adjustment features);
- e. Consider whether the difference between the total of the calculated gross [risk adjustment for non-financial risk](#) and the total of the ceded [risk adjustment for non-financial risk](#) fairly reflects the compensation that the [entity](#) requires for bearing the uncertainty of its net exposure; and
- f. When advising on the confidence level disclosure required by [IFRS 17](#), where [risk adjustment for non-financial risk](#) has not been determined using a confidence level approach, consider:
  - i. The ability to diversify [non-financial risk](#) over the [entity](#)'s consolidated business; and
  - ii. The inherent uncertainty in the translation to a confidence level and the need to describe such uncertainty in the [report](#).

2.6.14. [Aggregation and Contractual Service Margin \(CSM\)](#) – The [actuary](#) should treat the processes of:

- a. Identification of [portfolios of insurance contracts](#);
- b. Allocation of individual [insurance contracts](#) into [portfolios of insurance contracts](#), and division of each [portfolio of insurance contracts](#) into [groups of insurance contracts](#);
- c. Treatment of the [loss component](#) on [onerous contracts](#);
- d. Determination of the [coverage units](#); and
- e. Roll forward of the [CSM](#)

as being subject to [APN 901](#) paragraph 2.7.<sup>4</sup> or 2.8.<sup>5</sup>.

The [actuary](#) should disclose in the [report](#) changes in the above processes, including the rationale for and impact of the changes.

**2.7. The Premium Allocation Approach (PAA)** – When advising the [principal](#) or the [entity](#) in relation to the use of the [PAA](#) for a [group of insurance contracts](#), the [actuary](#) should:

- 2.7.1. At initial recognition if the [coverage period](#) is longer than one year, consider:
  - a. Differences between the expected patterns of insurance revenue under the [general measurement approach](#) and under the [PAA](#);
  - b. Differences between the expected timing of cash flows under the [general measurement approach](#) and the insurance revenue under the [PAA](#), resulting in different adjustments for the time value of money; and

- c. Whether future assumption changes under the [general measurement approach](#) would render the simplification invalid

when assessing whether material differences between the respective carrying amounts of the liabilities for remaining coverage under the [PAA](#) and the [general measurement approach](#) are reasonably expected to arise;

- 2.7.2. Assess whether [insurance contracts](#) in the group have a significant financing component, advise the [principal](#) or the [entity](#), and measure the liability accordingly;
- 2.7.3. Be aware of whether the [entity](#) has chosen in accordance with [IFRS 17](#) to recognize [insurance acquisition cash flows](#) as expenses when it incurs those costs and determine the liability in accordance with the [entity](#)'s choice;
- 2.7.4. Be aware of whether the [entity](#) has chosen to reflect the time value of money and the effect of financial risk, when not required to do so, and determine the liability in accordance with the [entity](#)'s choice; and
- 2.7.5. Consider whether facts and circumstances indicate that the [group of insurance contracts](#) is or has become [onerous](#) and advise the [principal](#) or the [entity](#) accordingly.

**2.8. The Variable Fee Approach** – In using the [variable fee approach](#), the [actuary](#) should apply the guidance in paragraph 2.6., except for 2.6.6. ([Reinsurance Contracts](#) Held) and 2.6.7. ([Reinsurance Contracts](#) Issued), as the [variable fee approach](#) does not apply to reinsurance.

## 2.9. Financial Statement Presentation and Disclosure

- 2.9.1. Where the information provided by the [actuary](#) will be used in financial statement presentation and disclosure:
- The [actuary](#) should provide the related information needed to comply with the relevant presentation and disclosure requirements of [IFRS 17](#) and the [entity](#)'s [accounting policies](#); and
  - If the [actuary](#) becomes aware that such information is used in the presentations and/or disclosures incorrectly or inappropriately, the [actuary](#) should discuss and report these issues to the [principal](#).
- 2.9.2. In providing advice on the disclosures of reconciliations where the order of calculations alters the information disclosed, the [actuary](#) should apply a consistent order of calculation across all reconciliations and from period to period, or disclose any change, including the rationale for and impact of the change, in the [report](#).

**2.10. Transition** – When advising the [principal](#) or the [entity](#) on whether a full retrospective application of [IFRS 17](#) at transition is impracticable, the [actuary](#) should take into consideration factors such as:

- The availability and integrity of the past [data](#) that are required to determine the [fulfilment cash flows](#);
- The availability and integrity of information on past products;
- The availability, without the benefit of hindsight, of sufficient [data](#) to determine the initial assumptions and subsequent changes that the [entity](#) would have adopted over the lifetime of the [insurance contracts](#);

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- d. The method that would have been used to adjust past known interest rates to achieve the rates that reflect the characteristics of the insurance contracts; and
- e. The difficulty, without the benefit of hindsight, in evaluating the past risk adjustment for non-financial risk and the entity's use of discretion.

### Section 3. Communication

- 3.1. Disclosures** – In addition to complying with [APN 901](#) Section 3. Communication, the [actuary](#) should disclose in the [report](#):
- 3.1.1. Information regarding a change in assumptions or method, whether arising from a consistent or changed process;
  - 3.1.2. Changes in processes, together with the rationale for and impact of the changes, related to:
    - a. The identification, combination, aggregation, separation, recognition, derecognition and modification (2.4.);
    - b. The selection of the measurement approach (2.5.);
    - c. The process for updating assumptions (2.6.2.);
    - d. Aggregation and [CSM](#) (2.6.14.); and
    - e. The order of calculation on reconciliations provided for financial statement presentation and disclosure (2.9.2.); and
  - 3.1.3. When the [risk adjustment for non-financial risk](#) has not been determined using a confidence level approach, the uncertainty inherent in the translation to a confidence level (2.6.13.f.).