

## Ten things insurance company directors should know about MFRS 17 *Insurance Contracts*

By MASB Staff

**Disclaimer:** *The views and opinions expressed in this article do not represent the official views of the Malaysian Accounting Standards Board (MASB). Official positions of the MASB on accounting matters are determined only after extensive deliberation and due process. Thus, this article is intended to convey the general information only and they should not be taken as the official MASB view.*

*Neither MASB nor any member of the MASB Secretariat accepts responsibility or legal liability arising from or connected to the accuracy, completeness or reliability of the materials and information contained in this article.*

The extent of the changes you'll need to make depends on the types of insurance contracts your company sells. For straight-forward annual contracts with up-front premiums, the impacts might be limited. For longer-term contracts, the impacts might be considerable.

### 1. The change is effective in 2021

MFRS 17 (which has requirements identical to IFRS 17 *Insurance Contracts*) supersedes MFRS 4 for reporting periods beginning on or after 1 January 2021.

For example, an insurer with a 31 March year end would need to have information systems in place to prepare MFRS 17-compliant financial statements for the year ended 31 March 2022 (with comparative financial statements for 31 March 2021, including a third balance sheet for 1 April 2020).

### 2. The same contracts are covered

The scopes of MFRS 17 and MFRS 4 are the same – so, conventional and takaful products currently accounted for under MFRS 4 will be covered by MFRS 17.

An 'insurance contract' involves one party accepting significant insurance risk from a policyholder by agreeing to compensate them if they are adversely affected by a specified uncertain future event. Insurance risks are non-financial risks, such as mortality, medical and property damage risks. Both MFRS 17 and MFRS 4 address contracts that bundle financial risk (involving investment/savings services) and significant insurance risk.

### 3. More contracts to be unbundled

Contracts covering both insurance risks and investment/savings services will need to be unbundled when the components are 'distinct' – that is:

- ~ not highly interrelated with the insurance component, or
- ~ equivalent investment contracts are sold separately or could be sold separately.

Financial instruments and/or revenue recognition standards would apply to the investment/savings components. In contrast, existing Malaysian practice is to treat many contracts that have 'distinct' components as if they are wholly insurance contracts.

### 4. Contracts could be longer or shorter

Contracts are deemed to end when an insurer has the practical ability to reassess the risks of either a particular policyholder or a portfolio of contracts and set a price or level of benefits that fully reflects the risk. These contract boundaries might be different from the contractually-specified periods, which are routinely used under existing Malaysian practice.

### 5. Earlier recognition of loss-making contracts

Each portfolio must be sub-grouped as:

- ~ onerous contracts, if any

- ~ contracts with no significant possibility of becoming onerous subsequently, if any
- ~ the remaining contracts, if any.

In contrast, existing Malaysian practice is usually to assess for loss-making contracts at the portfolio level. More granular accounting will often mean earlier recognition of loss-making contracts, even when a whole portfolio is profitable. It will also place greater demands on information systems.

## 6. Two measurement models

Malaysian life insurers would be familiar with measuring insurance liabilities using estimates of future cash flows, often discounted present values. And general insurers usually use a cash flow approach to measure liabilities for outstanding claims. These bases of measurement have some similarities with the **general model** for measuring insurance liabilities, which includes:

- ~ fulfilment cash flows, adjusted to reflect the time value of money
- ~ a risk adjustment for non-financial risk; and
- ~ contractual service margin (CSM), such that there is no day-one profit.

The general model is complex and insurers can apply a ‘simplified’ **premium allocation approach (PAA)** to measure liabilities for remaining coverage when:

- ~ contracts have coverage periods of a year or less; or
- ~ the resulting liability would not be materially different from the general model measure.

The PAA is more aligned with existing practice for general insurers; but is based on premium receipts. In contrast, existing Malaysian practice is to recognise unearned premium liabilities, which include premiums received and receivable.

To avoid the cost of applying the general model, many insurers are expected to make the effort to determine whether their contracts are eligible for the PAA.

## 7. More acquisition costs immediately expensed & no more DAC

Acquisition costs:

- ~ must be ‘directly attributable to a portfolio; and
- ~ are incorporated in measuring liabilities.

In contrast, existing Malaysian practice often involves acquisition costs being indirectly attributable and, for general insurers, recognising a deferred acquisition cost asset separate from the insurance liability.

## 8. Three ways to transition from MFRS 4 to MFRS 17

Insurance liabilities must be restated on transition:

- (1) **retrospective application** is required when practicable; otherwise
- (2) a **modified retrospective** approach that only uses retrospective information available without undue cost or effort; or
- (3) a **fair value** approach, such that the CSM at transition is the difference between the fair value of a group of insurance contracts and the fulfilment cash flows.

## 9. Financial assets can be re-designated

For financial assets, when insurers first adopt MFRS 9, entities determine the measurement based on the applicable business model:

- ~ cost when held to collect contractual cash flows that are solely payments of principal and interest;
- ~ fair value through other comprehensive income when held to both collect contractual cash flows and sell; or
- ~ fair value through profit or loss if not measured at either (a) or (b).

Ordinarily, these measurement bases are locked in; but, because MFRS 17 might change insurance liability measures, insurers can redesignate financial assets connected with insurance contracts when they apply MFRS 17, within the constraints of MFRS 9.

**10. What if I have implementation issues?**

The IASB Insurance Transition Resource Group (TRG) will consider IFRS 17 implementation issues and potentially make recommendations to the IASB.

<http://www.ifrs.org/groups/transition-resource-group-for-insurance-contracts/>

Any party can submit an issue to the TRG – if you have concerns, please first notify the MASB because the issue may also be of concern to others and the MASB may help to facilitate the matter – [technical@masb.org.my](mailto:technical@masb.org.my).