

Reinsurance contracts held: contract boundaries and recognition date

[This article is one in a series of articles (which can be found [here](#) and [here](#)) published on behalf of the [IFRS 17 CSM Working Party](#). Members are Antoon Pelsser, Asim Ghosh, Clarence Er, Huina Zhang, James Thorpe, Joanna Stansfield, Kruti Malde, Natalia Mirin (Deputy Chair), Richard Dyble, Rob Walton, Timothy Berry, Weihe Qin and Wijdan Yousuf (Chair).]

1. Overview

This article looks at some of the challenges for reinsurance contracts held with respect to the inclusion of future ceded new business within the contract boundary and the implications on when reinsurance should be recognised on the balance sheet. The article is written from the perspective of insurers and hence reinsurance held, however it should be noted that many of the points discussed also apply to reinsurance written.

2. Future new business in the contract boundary

2a. Technical assessment:

IFRS 17 states that all cashflows within the contract boundary that “arise from substantive rights and obligations” must be included in the fulfilment cashflows¹. It is common for reinsurance treaties to include a notice period to make change, applying to both parties of the treaties. Changes covered by such a notice period may include:

- stopping future new business from being ceded to or accepted for reinsurance
- changes to the future reinsurance premiums payable

Note that such a notice period creates a substantive obligation for the insurer to cede its future new business whilst the notice period is being served. Therefore reinsurance cash flows relating to new business the insurer expects to write during the notice period could be inside the reinsurance contract boundary under IFRS 17. This implication of the contract boundary requirements on reinsurance was discussed and acknowledged at the [February 2018 TRG](#)².

What period of future new business, if any, needs to be included in the contract boundary depends on the recognition date of the reinsurance contract and its notice period. We will discuss how these two factors interact in section 3. However, initially we will consider a simple example to demonstrate the principle of including future new business in the reinsurance contract boundary.

2b. Example:

An insurer has just launched a term assurance product. At the following reporting date it has not yet written any contracts, however it expects to write 1 term assurance contract each month going forward. It anticipates this business will be profitable. On the reporting date the insurer enters into a reinsurance treaty to reinsure all of the new term assurance contracts it writes. The reinsurance treaty has a 3 month notice period if the insurer wishes to stop ceding future new business.

Under IFRS 17, the underlying term assurance contracts will be recognised on the balance sheet as and when each contract is written³. As a result, there will currently be no term assurance contract liabilities appearing on the balance sheet.

¹ IFRS 17, paragraphs 33 and 34.

² The Transition Resource Group for IFRS 17 Insurance Contracts, a group run by IASB staff to provide a public forum for stakeholders to follow the discussion of questions raised on implementation.

³ See [article on initial recognition](#) for more details on the recognition date of the underlying contract.

We assume here the reinsurance contract is recognised on the reporting date⁴. Due to the notice period, the contract boundary for this reinsurance contract held will include the reinsurance cash flows relating to the following 3 months of new business, i.e. the future reinsurance premiums, reinsurance recoveries and related expenses in respect of the 3 contracts it expects to write over that period.

2c. Implications:

This requirement can clearly result in an accounting mismatch on the balance sheet. However, it can also lead to additional challenges for insurers. For example:

- **Operational complexities:** Including future new business in the contract boundaries is likely to result in a number of operational complexities, not least due to the need to determine assumptions for the volume and mix of the future new business. There is an open question on how sophisticated such approaches need to be.
- **Disclosure of commercially sensitive information:** By including assumptions for the volume and mix of future new business in the reported accounts, an entity risks disclosing commercially sensitive information. How easy it would be for competitors to determine such information from the accounts will depend on the nature of the business and the granularity of grouping and disclosure of results. In the example in 2b above, where the insurer has launched a new product line, it could be relatively straightforward to identify their future business plans from IFRS 17 disclosures. However, for a mature book of business, this risk would be lower.

3. Implications for reinsurance recognition date

3a. Technical assessment:

Notice periods on reinsurance treaties are generally of a rolling nature, e.g. a 3-month notice period can be served by either party at any time to stop future new business from being ceded. However, at [TRG in September 2018](#), it was clarified that the contract boundary created by the substantive obligations arising from such a notice period will be fixed from the date the reinsurance treaty is recognised. This has two consequences:

1. As alluded to in section 2a, the future new business to be included in the contract boundary is a factor of both the notice period and the recognition date of the reinsurance contract. The future new business to be included in the contract boundary is that expected to be written in the outstanding period from the reporting date to the end of the notice period fixed from the date of recognition.
2. Business ceded beyond this fixed contract boundary will form a new reinsurance contract on the IFRS 17 balance sheet, with a new recognition date and potentially in a different group of contracts, e.g. if the new recognition date is more than one year apart from contracts in the original group of contracts.

3b. Example:

Using our example in 2b above, let's assume the insurer enters into the reinsurance treaty on 31 December 2022. At that point, it assesses the treaty and determines that it should recognise a reinsurance contract (referred to as "r1") on the IFRS 17 balance sheet as follows:

- a) initial recognition date of 31 December 2022;
- b) the 3-month notice period implies a contract boundary that includes future new business up to and including 30 March 2023; and

⁴ IFRS 17 paragraph 62 sets out the recognition date requirements for reinsurance. Note that for proportionate reinsurance this will be the later of the date the reinsurance coverage period starts and the initial recognition of the first underlying contract covered by the reinsurance contract. For simplicity, this example assumes the recognition date is the treaty start date.

c) r1 is included in a group of reinsurance contracts held referred to as “R2022”⁵.

The insurer does quarterly reporting. On 31 March 2023, it remeasures the previously recognised reinsurance contract, r1. Since December, the insurer has written 4 term assurance contracts. Reinsurance of these 4 contracts will be included in r1, replacing in the fulfilment cash flows for the 3 underlying contracts it estimated at initial recognition. The original contract boundary has now expired and hence no future ceded new business under the reinsurance treaty should be included in r1. The insurer did not issue notice to the reinsurer on 31 December, hence there is future expected new business to be ceded under the treaty. The insurer will therefore recognise a new reinsurance contract, “r2”, as follows:

- a) initial recognition date of 31 March 2023;
- b) the 3-month notice period implies a contract boundary that includes future new business up to and including 29 June 2023; and
- c) r2 is included in the group of reinsurance contracts held, “R2023”.

Going forward, the insurer will recognise a new reinsurance contract every 3 months; at initial recognition each new contract will contain the following 3 months of new business. Whether the new contract falls into a new group will depend on whether it falls into a new cohort year or not.

3c. Implications:

On first reading, the IASB interpretation above seems at odds with the economics of a rolling notice period.

Consider the example in 3b but assume the reinsurance treaty was entered on 30 November 2022. The contract is subsequently measured at the first reporting date after this, i.e. 31 December 2022. At this point, the contract boundary would only include future new business up to and including 27 February 2023, despite the insurer knowing that, as notice has not been given, they must cede new business up to and including 30 March.

We can follow this argument through to consider the situation where the reinsurance treaty was written on 1 October 2022, where the contract boundary will include future new business up to and including 31 December. When the insurer measures the reinsurance contract held on 31 December, they do not need to include any future new business in the contract boundary, however, neither do they need to recognise a new reinsurance contract yet.

Therefore, it could be possible to resolve the challenges identified in section 2c above, by synchronising the dates on which reinsurance treaty notice periods expire with reporting dates.

There are some points to consider to make this work:

- Does the wording of existing reinsurance treaties, particularly with respect to notice period clauses, need to be amended to achieve synchronisation? Depending on a company’s transition approach, this may be deemed to be unnecessary (e.g. if applying Fair Value Approach), or simplifications to avoid its need may be justifiable.
- For future treaties, how can the notice period and/or treaty start dates be structured to achieve synchronisation without restricting commercial activity? It is worth starting discussions with the internal teams and reinsurers early to find a workable solution.
- For synchronisation to work, notice periods will need to be based on calendar months rather than number of days, e.g. 3 months rather than 90 days.

As well as the opportunity to explore synchronising notice periods and reporting dates, the above interpretation of fixed contract boundaries has other advantages. In particular, this results in multiple reinsurance contracts being recognized with different recognition dates within a single

⁵ We assume the insurer bases its annual cohorts on calendar years.

reinsurance treaty. This reduces the degree of mismatch between underlying insurance contracts and reinsurance contracts held in areas such as discount rates.

4. Conclusion

The treatment of future new business under reinsurance contracts has been clarified by discussions at a number of TRG meetings. Whilst the latest interpretation arguably doesn't represent the economics of reinsurance notice periods, it offers opportunities for insurers to explore that may help mitigate some of the challenges arising if future new business is included in the reinsurance contract boundary.

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