

Measurement of Onerous Contracts

Introduction:

Onerous contracts are insurance contracts that are loss making from inception or become loss making during the lifetime of the contract. A Loss Component ("LC"), depicting the total expected loss under the contract is created in case of an onerous contract and is rolled-forwarded at each subsequent measurement.

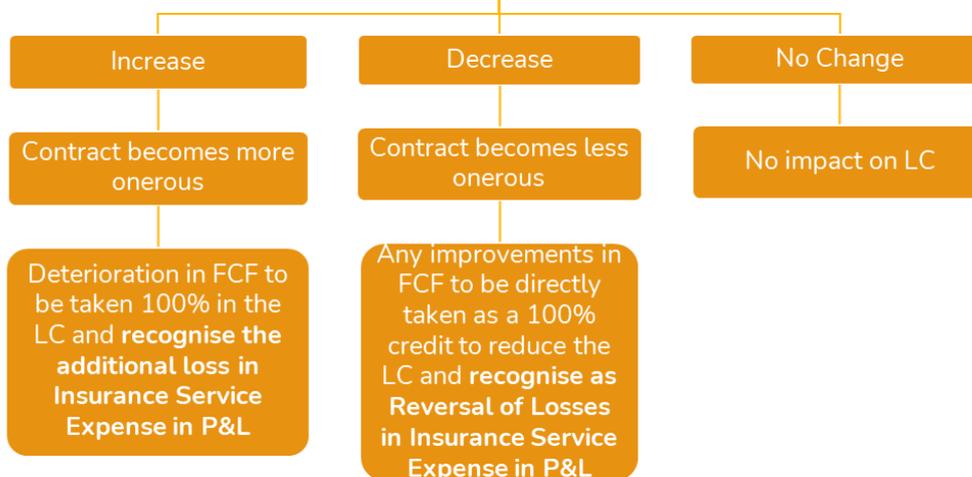
How to Onerous Contracts work?

At Initial Recognition, assess FCF. If $FCF > 0$, then $CSM = 0$. Contract is onerous. Set $LC = \text{value of FCF}$. Recognise the amount of the FCF as a loss immediately in the Insurance Service Expense in P&L

Just after Initial Recognition (Time 1), nothing has changed, contract is still onerous but the Company has received 1st premium and incurred initial expenses. Assess the ratio to systematically allocate the loss between LC and Remaining Component (RC). **Systematic Allocation Ratio (SAR) = FCF at Initial Recognition (which is the same as LC) / FCF at time 0 including time 0 cashflows**

At Subsequent measurement, $Loss\ Component = SAR * [Insurance\ finance\ expense - Release\ in\ RA\ due\ to\ release\ of\ risk - Expected\ insurance\ service\ expense] + LC\ Adjustment$

LC adjustment = Effect of changes in FCF with respect to Future Service



Any change in FCF on account of change in estimates of future cashflows (such as changes in assumptions, model, methodology etc.) is fully allocated to Loss Component till it becomes zero and a CSM is created.

To gain more insights on Onerous contracts and how they are measured under IFRS17 or for any other related discussions, please feel free to reach out to us at kap@ka-pandit.com



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