IFRS 17 Insurance Contracts: Reinsurance to close transactions

Executive Summary

Project Type	Endorsement
Project Scope	Significant

Purpose of the paper

This paper addresses the application of IFRS 17 to reinsurance to close (RITC) transactions in the Lloyd's market. It presents an update to the issues considered by the Board in January 2022 and draft material for inclusion in the final IFRS 7 ECA.

Summary of the Issue

The January 2022 Board paper presented the discussions with stakeholders and analysis of issues arising from the application of IFRS 17 to Lloyd's market RITC transactions. The Board requested further information on the accounting effects and the potential scale of the impact on the economy. The Appendices to this paper set out drafts of material for inclusion in the final IFRS 17 ECA as follows: (a) an assessment against the technical accounting criteria and (b) an assessment of the impact on business conducted by the UK insurance industry. This paper also provides further comment on current accounting requirements under IFRS 4.

Decisions for the Board

The Board is asked:

1. to approve the draft material in the Appendices to this paper for inclusion in the final IFRS 17 ECA.
2. whether, on the basis of the issues arising in respect of the application of the standard to RITC contracts, any other revisions are needed to its overall decision to adopt IFRS 17 for use in the UK without modification.

Recommendation

We recommend the Board approves the draft material in the Appendices, subject to any drafting amendments required by the Board, for inclusion in the final IFRS 17 ECA. We do not recommend changes to the Board's overall decision to adopt IFRS 17 for use in the UK without modification.

Appendices

Appendix 1 – draft assessment of the expected accounting for RITC transactions under IFRS 17 against the technical accounting criteria

Appendix 2 – draft assessment of the impact of the expected accounting for RITC transactions under IFRS 17 on the UK insurance industry

Introduction

1. Agenda paper 4.0 of the Board's January 2022 meeting (the January 2022 Board paper) provided a summary of discussions with stakeholders and issues arising from the application of IFRS 17 to reinsurance to close (RITC) transactions on the Lloyd's market. At that meeting the Board requested further information in respect of:

   a) the accounting effects of applying IFRS 17 to RITC transactions; and

   b) the potential scale of the wider impact on relevant entities and on the Lloyd's market.

2. This paper builds on the information included in the January 2022 Board paper and sets out additional information, to the extent it is available t. The paper also contains further comment on current accounting requirements under IFRS 4: including the options available to industry and other relevant context for the adoption decision the Board is required to make.

Current accounting under IFRS 4

3. As explained in the January 2022 Board paper (paragraphs 16 and 17), under IFRS 4 (and under UK GAAP) RITC contracts have generally not been treated as reinsurance contracts. Instead, the industry consensus has been to treat RITC transactions as effective transfers of insurance obligations: ceding members derecognise their interest in the relevant insurance liabilities and reinsuring members recognise the liabilities on the same basis. Changes in participation levels are in practice treated as changes in estimates.

4. However, IFRS 4 derecognition requirements are very similar to those in IFRS 17. Leaving aside modification scenarios, which do not apply to RITC transactions, there is no change to the fundamental requirement. IFRS 4 states that an insurer:

   "*shall remove an insurance liability [.....] from its statement of financial position when, and only when, it is extinguished – ie when the obligation specified in the contract is discharged or cancelled or expires*." [IFRS 4: 14 (c)]

5. IFRS 17 paragraph 74 states:

   "An entity shall derecognise an insurance contract when, and only when:

   a) it is extinguished, ie when the obligation specified in the insurance contract expires or is discharged or cancelled; or

   b) any of the conditions in paragraph 72[1] *are met."*

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[1] Paragraph 72 of IFRS 17 sets out the conditions under which the modification of a contract leads to derecognition of the contract and recognition of the modified contract as a new contract. We understand there is industry consensus that none of those conditions are relevant in the case of an RITC contract. Other contract modifications are treated as changes in estimates of cash flows (IFRS 17 paragraph 73).

6. Further, IFRS 4 states that an insurer "*shall not offset reinsurance assets against the related insurance liabilities*" [IFRS 4: 14 (d)]

7. In summary, therefore, it appears that IFRS 17 introduces no change to the key requirements that drive the accounting for RITC contracts. Although its basis is not wholly clear, current UK accounting under IFRS 4 may be based on custom that has developed from UK GAAP, and on an interpretation in which RITC contracts are not viewed as reinsurance. UK companies might therefore continue to make similar judgements concerning the nature and effect of RITC contracts which lead to the current accounting approach. Alternatively, if there is to be a change in accounting treatment, which is the current expectation, companies will need to explain the basis for the change including the extent to which it represents the correction of a prior year error.

Accounting effect of IFRS 17 on RITC transactions

Balance sheet

8. Appendix 1 to the January 2022 Board paper contained illustrative examples of how insurance contract assets and liabilities are expected to be presented in the balance sheet. Illustrative example 3 is reproduced here for ease of reference:

Base scenario

- The 2023 year of account is reinsured by means of an RITC contract into the 2024 year of account (at the end of 2025)
- Syndicate policyholder liabilities of £100,000 comprise: £80,000 liability for incurred claims (LIC) and £20,000 unearned premium (LRC)
- £100,000 of assets (cash) are transferred between the years of account to support the liabilities

Illustrative example 3 – increase in participation

The Corporate Member participates 50% in the 2023 year of account and 70% in the 2024 year of account.

	PRE	POST-RITC			
	2023	2023	2024	Elim.	Total
Cash	50,000		70,000		70,000
Reinsurance asset		50,000		-50,000	-
LIC	-40,000	-40,000			-40,000
LRC	-10,000	-10,000			-10,000
Reinsurance LRC			-70,000	50,000	-20,000

9. The January 2022 Board paper referred to the fact that two different measurement bases might need to be applied to the same group of contracts. This is because whereas many corporate members will apply only the Premium Allocation Approach (PAA) to their original insurance contract liabilities, in many cases any reinsurance liability (under an RITC contract) will be a liability for remaining coverage accounted for under the General Measurement Model (GMM).

10. The PAA is a simplified measurement model applied for a group of insurance contracts if, at inception, the PAA provides a reasonable approximation to the GMM or the coverage period of each contract in the group is one year or less. It is expected that this second condition will often be met for contracts typical at Lloyd's. This is because they are non-life contracts covering periods of one year – i.e. they cover risks arising during a 12 month period.

11. Under the PAA the initial measurement of the liability equals the premium received, which is then released over the coverage period (generally on a straight-line basis). In IFRS 17 terms this is the liability for remaining coverage (LRC) and in the example above is the balance of 10,000.

12. At the point when an RITC transaction is carried out, risks may have materialised – that is, claims may have been made. In the closing balance sheet those claims will form the liability for incurred claims (LIC), in the example above the balance of 40,000.

13. Although the original contract coverage period might have been one year, the period to ultimate settlement of claims might be much longer, potentially many years in the case of, say, major storm damage. The party taking on the liabilities is therefore taking on a different type of obligation: the uncertain obligation now relates to the amount ultimately required to settle incurred claims rather than to whether a claim will arise in the first place. The insured event is the determination of the ultimate cost of those claims. At this point it is more likely that the PAA will not be permitted and that the GMM will have to be used, primarily because the coverage period is much longer.

14. When a member increases its participation in a syndicate, as in the example above, the resulting reinsurance liability (the new element compared with current accounting) is a liability for remaining coverage and may need to be measured using the GMM. Both the 40,000 LIC and the 20,000 LRC relate to the same underlying liabilities, and both would continue to be recognised until the liabilities were settled.

Profit or loss

15. The IFRS 17 measurement models are expected to lead to more complex accounting in profit or loss than is typically the case currently. The requirements in respect of CSM recognition and insurance finance income and expense (including the effects of the unwind of discounting), for example, potentially introduce additional elements to the accounts irrespective of RITC accounting.

16. More specifically, for RITC transactions the recognition of reinsurance balances may give rise to CSM amounts that would then need to be allocated to the relevant coverage periods. In the illustrative example above, in practice a CSM might arise in relation to the Reinsurance LRC of 20,000. This would in essence represent the difference between

the RITC premium and the measurement of the fulfilment cash flows, and would need to be allocated to the periods over which the liabilities were expected to be settled.

17. In cases when a member's participation declines, the expectation is that a reinsurance asset will be recognised corresponding to the underlying liabilities that continue to be recognised. The measurement of the fulfilment cash flows of the reinsurance asset would generally be expected to match those of the underlying liabilities so no 'mismatch' should occur in that respect. However, depending on the pricing of the RITC premium, the transaction may give rise to either a day one loss[2] or a credit balance CSM. Although it seems perhaps more likely that a day one loss will arise, in which case the accounting would be essentially the same as now, a credit balance CSM might arise that would give rise to P&L impacts over the coverage period.

Potential scale of impact

Impact on relevant entities

18. As confirmed in the January Board paper, additional accounting complexity and cost is expected to arise, both under scenarios in which a corporate member increases its participation in a syndicate and under scenarios in which its participation declines or ceases. In particular, if a corporate member exited a syndicate completely, it would still need to maintain its accounting for its participation in the earlier year of account (insurance liabilities and a corresponding reinsurance asset). Such accounting would be required until the liability was extinguished, which in some cases could be a number of years.

19. We are aware of four UK listed insurance companies with Lloyd's operations that produce group accounts using IFRS, three of which responded to our preparer survey. While all three reported in the survey that they expected ongoing costs to increase under IFRS 17, only one referred specifically to RITC in that context. That respondent also provided the only quantification of the expected annual cost increase: £1.1m in total (i.e. not just for RITC accounting), equal to approximately 1% of annual operating costs. These costs were factored into the overall cost benefit assessment in Section 4 of the DECA.

20. As noted in the January 2022 Board paper, the RITC working group acknowledged that the accounting issues arising from the application of IFRS 17 to RITC contracts were probably not currently material to UK IFRS reporters, considering the activity in recent years. However, such issues could potentially become more significant in future.

Wider impact on Lloyd's market

21. The January 2022 Board paper explained that stakeholder's key concerns related to:

    a) market efficiency;

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[2] IFRS 17 requires a net cost or purchasing reinsurance to be recognised immediately in profit or loss when the reinsurance coverage relates to events that occurred before the purchase of the reinsurance contracts – adverse development cover

b) competition; and

c) availability of data.

22. As reported in the DECA, the estimated annual gross written premiums (GWP) of the total UK insurance market amounts to some £264bn, of which £157bn, or 60%, relates to UK insurance companies applying IFRS.

23. The Lloyd's market accounted for £35.5bn of GWP in 2020. However, this amount includes business included in the accounts of non-UK companies and companies not applying IFRS. The proportion accounted for by non-UK business is unclear but is estimated to comprise a significant proportion of the total Lloyd's market.

24. Based on information in their accounts, the four UK listed companies participated in 16 of the 76 syndicates active at Lloyd's. We estimate that in 2020 these groups accounted for between £5.5bn and £6bn of GWP at Lloyd's, or between 15% and 17% of the aggregate GWP of the Lloyd's market.[3]

25. As noted in the January 2022 Board paper, preliminary information from Lloyd's indicates that as at 31 December 2020 there were five or six third-party RITC transactions[4], involving gross reserves of approximately £1.8bn. These transactions did not involve current UK IFRS reporters. We understand from Lloyd's that there are at least five syndicates currently dedicated to acquiring legacy/run-off business through RITC transactions.

Availability of data

26. The January 2022 Board paper referred to concerns that members exiting a syndicate would no longer receive the information necessary to enable them to continue to account for their insurance liabilities. Issues concerning the lack of data arise only when a member exits a syndicate entirely.

27. We have been informed by Lloyd's that policy, claim and other transactional data is held and managed by managing agents and used to prepare accounting records for the syndicates they manage. A corporate member's accounts are prepared based on the member's share of the relevant syndicate balance sheets and income statements by year of account. Where the member and managing agent are under common ownership, they are able to share syndicate data internally to achieve this. In practice, in such situations, one finance team prepares the accounts of both syndicate and member.

28. Where there are third party corporate members, the syndicate prepares additional templates in their 'QMA' return to Lloyd's (UK GAAP financial reporting information). This includes a UK GAAP balance sheet for each year of account in addition to profit or loss information. Lloyd's calculates each third party member's share of the relevant syndicate's balance sheet and income statement and distributes this data to those

[3] NB: this is a broad estimate only as data is not readily available from the accounts

[4] Where, rather than 'transferring' the share to other members of the original syndicate, a ceding member 'transferred' their share to an entirely different syndicate

members. IFRS reporters need then to create IFRS accounts based on the underlying UK GAAP information.

29. Once a year of account is closed, it is no longer included in the data distributed to members.

30. The need to receive data sufficient to enable the preparation of IFRS accounts therefore applies to all members participating in a syndicate, irrespective of the existence of RITC transactions. The additional administrative burden from the RITC accounting appears to lie primarily in the need to widen the distribution of the information to include prior members as well as current members. We are not aware of any fundamental barrier to making the necessary data available in future.

Consultation feedback and the IFRS 17 adoption decision

31. Consultation feedback is addressed in more detail in paper 3 to this meeting. In summary, no respondent to the DECA has explicitly called for IFRS 17 to be modified in respect of RITC contracts before it can be adopted for use in the UK. Of the six respondents who comment specifically on the issue, three state explicitly that they do not consider that the standard should be modified for this issue. The responses of the other two respondents are silent or ambiguous on this specific question.

32. As previously noted, non-UK entities also participate extensively in Lloyd's syndicates, including entities that apply IFRS and will therefore apply IFRS 17.[5] Any UK-only modification of the standard or other unilateral steps is therefore unlikely to provide an effective solution to concerns over the impact of IFRS 17 on the Lloyd's market. An accounting firm commented that "*a UK-adopted modification may consequently result in reduced comparability and usefulness of the financial information reported by entities that participate in Lloyd's syndicates and may create additional complexity for some preparers and users. Therefore, we do not believe IFRS 17 should be modified in this regard*."

33. The central concern expressed by the insurance industry appears to relate to "*the incorrect treatment of the RITC as a reinsurance arrangement*." However, as explained above, IFRS 17 introduces no change that directly affects this judgement.[6]

Questions for the Board

34. The Secretariat proposes to include additional information in the final Endorsement Criteria Assessment (ECA) to address the key issues and findings in relation to the RITC transactions (see drafts in Appendices 1 and 2). However, in respect of RITC contracts,

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5 We are not aware that companies in other jurisdictions have raised any concerns over the application of IFRS 17 to RITC transactions.

6 The DECA response from one professional body commented: "*While we recognise the operational and reporting complexities and cost challenges that exist for RITC under IFRS 17, we believe this to be a matter of interpretation and should not prevent the UKEB finalising the endorsement of IFRS 17. We expect the industry to consider and assess alternative interpretations which reflect the substance of the RITC transaction and avoid, [...], the potentially significant operational changes to the Lloyd's market*."

the Secretariat has not identified compelling reasons necessitating a modification to the standard as issued by the IASB.

Questions for the Board	
35.	Does the Board have any comments or questions on the additional information provided in this paper?
36.	Does the Board approve the draft material in the Appendices for inclusion in the ECA, subject to any drafting amendments required by the Board?
37.	Does the Board agree that, on the basis of the issues arising in respect of the application of the standard to RITC contracts, no revisions are needed to its overall decision to adopt IFRS 17 for use in the UK without modification?

Reinsurance to close transactions (RITC) in the Lloyd's market

IFRS 17 requirements

RITC contracts are a mechanism in the Lloyd's market to 'transfer' insurance liabilities from one year of account to the next. RITC transactions take the form of the reinsurance of those liabilities, effected by the payment of a reinsurance premium by the members of the closing year (the ceding members) to the members of the accepting year (the reinsuring members).

IFRS 17 does not explicitly address the accounting for RITC transactions in the Lloyd's market. The requirements of IFRS 17 most directly relevant to the accounting questions arising in respect of RITC transactions are those relating to the presentation of reinsurance assets and liabilities and to derecognition of insurance liabilities.

IFRS 17 requires that reinsurance contracts issued are accounted for by the reinsurer using either the general measurement model (GMM) or the premium allocation approach (PAA), in the same way as other insurance contracts issued. [IFRS 17: 3]

IFRS 17 requires a reinsurance contract held to be accounted for separately from the underlying insurance contracts to which it relates, to reflect its separate rights and obligations. [IFRS 17: BC298] IFRS 17 also requires the separate presentation of amounts relating to reinsurance contracts held and underlying insurance contracts on the balance sheet and in profit or loss. [IFRS 17: 78 and 82]

IFRS 17 requires the derecognition of an insurance contract when, and only when, it is extinguished (i.e. the obligation expires or is discharged or cancelled) or when it is modified in certain specified ways. [IFRS 17: 74]

Disclosures

RITC transactions would be included in the disclosures required generally to explain recognised amounts (IFRS 17 paragraphs 97 to 116). These include separate reconciliations for reinsurance contracts held showing how the net carrying amounts of contracts changed during the period. [IFRS 17: 98] Separate disclosure is also required of the effect of reinsurance contracts held initially recognised in the period and of when the CSM relating to reinsurance contracts remaining at the end of the reporting period is expected to be recognised. [IFRS 17: 107 and 109]

In addition, IFRS 17 paragraph 94 contains the general requirement that, if the specific disclosures required by the standard are not enough to meet the overall objective of enabling users of the accounts to assess contracts' effect on the entity's financial position, financial performance and cash flows, an entity shall disclose additional information necessary to meet this objective.

Accounting impact

Developing consensus in the UK is that an RITC is a reinsurance transaction, so the following assessment is based on that assumption.

Parties to an RITC contract are other syndicate members: it does not involve policyholders or change any terms of the underlying insurance contracts. An RITC contract is therefore unlikely to represent the modification of the terms, or the extinguishment, of the underlying insurance contracts. Derecognition of the underlying insurance contract liabilities by the members of the closing year of account (the ceding members) is therefore unlikely.

On this basis, under IFRS 17 a member would continue to recognise insurance liabilities from earlier years of account after entering into an RITC contract. The member's interests in the earlier and later years of account would need to be recognised on a gross, consolidated basis.

Under IFRS 17, when insurance contracts cover events that have already occurred, but the financial effect of which is still uncertain, the insured event is the determination of the ultimate cost of those claims.[1] [IFRS 17: B5] As the insured event has not yet occurred, the reinsurance liability is classified as a liability for remaining coverage. For many RITC contracts, as the period to ultimate settlement will be greater than one year, such reinsurance liabilities may need to be accounted for under the GMM.

This may create an operational burden for insurance companies that might otherwise only apply the PAA to contracts they issue. In cases where the original insurance contract liabilities are accounted for under the GMM, two different CSMs and potentially also two different risk adjustments would need to be recognised for the same group of contracts. In each of these circumstances, complexity would be compounded if there were a second RITC transaction in a subsequent year for the same contracts.

If a corporate member exited a syndicate completely via such RITC transactions, it would still need to maintain its accounting for its participation in the earlier year of account (i.e. it would present liabilities and a corresponding reinsurance asset). Such accounting would be required until the liability was extinguished, which in some cases could be a number of years.

The recognition of reinsurance balances may give rise to CSM amounts that would then need to be allocated to relevant coverage periods. In cases when a reinsurance asset is recognised, the transaction may give rise to either a credit balance CSM, leading to profit or loss impacts over the coverage period, or a day one loss.

A fully retrospective approach to transition will in many cases not be possible since the necessary records for the liabilities previously derecognised under IFRS 4 will generally not be available to members.

[Tentative] Assessment against the technical accounting criteria

The application of IFRS 17's requirements to RITC contracts is likely to result in greater complexity compared with current accounting. In addition, the recognition of reinsurance assets and/or liabilities and the application of the GMM may not be aligned with users' or preparers' current expectations. These factors may potentially **reduce understandability**.

The industry considers the likelihood of ceding members being called upon to settle insurance liabilities from the earlier year of account to be remote (given the security arrangements operating in the Lloyd's market and in particular the fact that Lloyd's Council may use its discretion to apply the Lloyd's Central Fund in cases when reinsuring members cannot meet their obligations). The inability for ceding members to derecognise such liabilities may be considered to present a **risk to reliability and understandability** of their financial position.

However, where a member's participation increases, the accounting under IFRS 17 reflects the fact that the additional portion is a reinsurance liability by nature, that it was 'acquired' from third parties, and that the member incurred it at a different time and potentially at a different price from the original liability, reflecting the view of insurance risk at the time of the RITC. Where relevant, the application of a different accounting model (i.e. GMM rather than PAA) would reflect the fact that the uncertain obligation relates to the settlement of incurred claims rather than to whether a claim would arise in the first place. Similarly, in a case where a member's participation has declined, the expected accounting reflects the fact that the member retains the ultimate legal liability for the underlying insurance contracts but has received (and paid for) reinsurance

[1] This assessment is written on the assumption that an RITC contract covering liabilities for incurred claims (as opposed to liabilities for remaining coverage) meets the definition of insurance contract.

coverage from third parties. In both scenarios, the expected accounting under IFRS 17 fairly reflects the underlying contractual substance, **enhancing reliability**.

The expected accounting for RITC contracts under IFRS 17 is consistent with that for reinsurance more generally and also with that for transfers of insurance contracts[2], **enhancing comparability**.

Further, the application of IFRS 17's derecognition requirements to RITC contracts will result in consistency of treatment with other (re)insurance contracts and with financial liabilities more generally. Under IFRS 9 *Financial Instruments* a financial liability is derecognised when, and only when, it is extinguished[3] or when it is substantially modified[4]. Similarly, under IAS 32 *Financial Instruments: Presentation*, even when 'back-to-back transactions' ensure that specific financial assets and liabilities are precisely matched, gross recognition is required except where there is a legal right of set-off[5]. Such consistency **enhances comparability** and, ultimately, broader **understandability**.

Accounting for RITC contracts under IFRS 17 is expected to affect only a small number of UK companies, and for those companies the impact on the accounts is unlikely to be material. Where the acquisition of insurance business at Lloyd's by means of RITC transactions is a significant part of a company's business, or when a company significantly decreases its participation in a syndicate, then it is likely that the company will need to explain the impact of such transactions to users of the accounts in any event.

The application of IFRS 17 may lead companies to reconsider their existing accounting treatment of RITC contracts in the UK so may pose a minor risk to **understandability** on initial application of IFRS 17. However, such concerns are likely to decline over time and will be mitigated by IFRS 17's disclosure requirements. Further, these risks need to be balanced with the **enhanced reliability** derived from an accurate presentation of the underlying contractual substance of transactions, and with the objective of consistency with other IFRS Standards and hence **enhanced comparability**.

[2] See also the analysis in respect of Contracts acquired in their settlement period (pages xxx to xxx above).

[3] When the obligation specified in the contract is discharged or cancelled or expires. [IFRS 9 3.3.1]

[4] A substantial modification of the terms of an existing financial liability, or a part of it, is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. [IFRS 9 3.3.2]

[5] In accordance with IAS 32.42 a financial asset and a financial liability are offset when, and only when, an entity currently has a legally enforceable right to set off the recognised amounts and the entity intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

RITC transactions – draft paragraphs for inclusion in UK Long Term Public Good assessment in ECA

Material to be included in section dealing with 'Potential impact on business conducted by UK insurance industry' (from page 91 of DECA)

Background

1. Insurance business at Lloyd's is written through syndicates. The nature of underwriting at Lloyd's is that each syndicate member is responsible for its share of each contract underwritten based on the proportion of capital each member has contributed to the syndicate. All the syndicate's assets, liabilities, income and expenses are shared in proportion to the capital contributed.

2. In its accounts, a corporate member aggregates its shares of the assets and liabilities of each year of account in which it participates.

3. The Lloyd's year of account mechanism means that Lloyd's members provide capital for one underwriting year of account at a time. Having underwritten one year of account, each member can decide whether to continue underwriting for the next year of account. Each individual year of account is a separate annual venture.

4. Lloyd's members cannot take their profit for a year of account at the end of that year. Instead, they must wait a period, typically three years from the beginning of the year of account, before they receive a profit, or are asked to make good losses, from that year of account.

5. RITC is a mechanism to 'transfer' insurance liabilities from one year of account to the next, typically at the end of three calendar years. It may be viewed as the reinsurance of an entire year of account, effected by the payment of a reinsurance premium by the members of the 'closing' year (the ceding members) to the members of the 'accepting' year (the reinsuring members). This occurs even if members wish to maintain their participation in the syndicate. Following an RITC transaction, a ceding member is allowed to withdraw its capital in respect of the closing year of account.

6. The RITC typically reinsures the liabilities into the next year of account of the same syndicate, though it could also be to a different syndicate. The level of participation of a member in a syndicate may vary from one year of account to the next, and members may enter or exit a syndicate.

Current accounting under IFRS 4

7. Under IFRS 4 (and under UK GAAP), RITC contracts have generally not been viewed as reinsurance contracts. Instead, they have been treated as transferring obligations under insurance contracts from the members participating in one year-of-account to those participating in a later year of account. The ceding members of the syndicate derecognise the relevant insurance liabilities and the receiving (reinsuring) members recognise the liabilities on the same basis. In practice, changes in the level of participation may be achieved by simply adjusting the relevant balances, as for a change in estimates.

Expected impact of IFRS 17 on relevant entities

8. The expectation is that RITC contracts will be treated as reinsurance contracts under IFRS 17, and that the criteria for derecognising the corporate member's interest in the earlier year of account (the original insurance contract liabilities) are unlikely to be met. Similarly, it seems unlikely that an RITC contract represents the modification of the terms of an insurance contract under IFRS 17.

9. On the basis of the expectation summarised in the previous paragraph, a corporate member would be expected to continue recognising the insurance liabilities from the earlier year of account even after entering into an RITC contract. This means that its interest in the earlier and later years of account would need to be recognised on a 'gross', consolidated basis.

10. Whereas many corporate members will apply only the Premium Allocation Approach (PAA) to their original insurance contract liabilities,[1] in many cases any reinsurance liability (under an RITC contract) will be a liability for remaining coverage accounted for under the General Measurement Model (GMM). Additional accounting systems will need to be established and two measurement bases will be applied to the same group of contracts.

11. In cases where the original insurance contract liabilities are accounted for under the GMM, two different CSMs and potentially also two different risk adjustments will need to be recognised for the same group of contracts.

12. In each of these circumstances, complexity would be compounded if there were a second RITC transaction in a subsequent year for the same contracts.

13. Compared with current accounting, therefore, additional complexity and hence cost is expected to arise for relevant entities, both in scenarios in which a corporate member increases its participation in a syndicate and in scenarios in which its participation declines or ceases.

14. However, we are aware of only four UK listed insurance companies with Lloyd's operations that produce group accounts using IFRS. Three of these companies responded to our preparer survey. While all three reported in the survey that they expected ongoing costs to increase under IFRS 17, only one referred specifically to RITC in that context. That respondent also provided the only quantification of the related expected annual cost increase: £1.1m in total (i.e. not just for RITC accounting), equal to approximately 1% of annual operating costs. These costs are factored into the overall cost benefit assessment in this Section 4.

15. Stakeholders acknowledge that, based on activity in recent years, the accounting issues arising from the application of IFRS 17 to RITC contracts were not material to UK IFRS reporters. While such issues could potentially become more significant in future, based on the above analysis, it seems unlikely that the application of IFRS 17 to RITC transactions in the UK would have a significant impact on the UK insurance industry.

[1] Due to the fact that their contracts are non-life contracts with coverage periods of one year or less

Potential wider impact on the Lloyd's of London market

16. Stakeholders have the following key concerns:

    a) *Market efficiency*: RITC is considered an effective method of transferring liabilities and corresponding assets and ensures low barriers to market entry and exit. If exiting the market were made significantly more difficult, this could damage the attractiveness of the Lloyd's market.

    b) *Competition*: IFRS reporters could be at a disadvantage to corporate members reporting using a different GAAP that permits less complex accounting.

    c) *Availability of data*: the necessary data to enable exiting members to continue to account for the original insurance contract liabilities would not be available to members exiting the syndicate entirely given current Lloyd's market practices. Data required for the ongoing accounting is currently provided only to the reinsuring members.

17. We understand that alternatives to the current RITC mechanism would include novation of liabilities or Part VII transfers but that both alternatives would require considerably more time and resources on behalf of the Lloyds members to achieve.

18. The estimated annual gross written premiums (GWP) of the total UK insurance market amounts to £264bn, of which £157bn, or 60%, relates to UK insurance companies applying IFRS (for sources, see paragraphs 4.XX above).

19. The Lloyd's market accounted for £35.5bn of GWP in 2020 (see paragraph 4.20 above). However, this amount includes business included in the accounts of non-UK companies and companies not applying IFRS. The proportion accounted for by non-UK business is unclear but is estimated to comprise a significant proportion of the total Lloyd's market.

20. The four UK listed companies participated in 16[2] of the 76 syndicates active at Lloyd's. We estimate that in 2020 these groups accounted for between £5.5bn and £6bn of gross written premiums (GWP) at Lloyd's, or between 15% and 17% of the aggregate GWP of the Lloyd's market.[3]

21. Preliminary information from Lloyd's indicates that as at 31 December 2020 there were five or six third-party RITC transactions[4], involving gross reserves of approximately £1.8bn. These transactions did not involve current UK IFRS reporters. We understand from Lloyd's that there are at least five syndicates currently dedicated to acquiring legacy/run-off business through RITC transactions.

22. All members participating in a syndicate need to receive sufficient data to enable the preparation of IFRS accounts, irrespective of the existence of RITC transactions. The additional administrative burden on application of IFRS 17 appears to arise primarily from the need to widen the distribution of the information to prior members who may

[2] Based on information in their most recent annual financial statements.
[3] NB: this is a broad estimate only as data is not readily available from the accounts
[4] Where, rather than 'transferring' the share to other members of the original syndicate, a ceding member 'transferred' their share to an entirely different syndicate

have transferred their participation. We are not aware of any fundamental barrier to making the data available to those members.

23. As previously noted, non-UK entities also participate extensively in Lloyd's syndicates, including entities that apply IFRS and that will be adopting IFRS 17 once it becomes effective.[5] Any UK-only modification of the standard or other unilateral step is therefore unlikely to provide an effective solution to concerns over the impact of IFRS 17 on the Lloyd's market.

24. On the basis of the analysis above, while recognising the additional operational burden likely to result from the application of IFRS 17 to RITC transactions compared with current accounting, it seems unlikely that in this respect IFRS 17 will have a significant adverse impact on the UK insurance industry or wider UK economy.

[5] We are not aware that companies in other jurisdictions have raised any concerns over the application of IFRS 17 to RITC transactions.