

● IFRS 17 EXPLAINED

EPISODE 1

What's Inside the **LRC**? A Step-by-Step Breakdown

PVFCF · Risk Adjustment · CSM — decoded for Indonesian insurers.

What Is the LRC?

IFRS 17 · EPISODE 1

“ *The LRC represents the insurer's obligation to provide **coverage and services** for the unexpired portion of the insurance contract.* ”

IFRS 17, Para 32 — IASB (2023)

$$\text{LRC} = \text{FCF} + \text{CSM}$$

LRC FORMULA

Fulfilment Cash Flows plus
Contractual Service Margin



$$\text{FCF} = \text{PVFCF} + \text{RA}$$

FCF FORMULA

Present Value of Future Cash
Flows plus Risk Adjustment



$$\text{LRC} + \text{LIC}$$

TWO-COMPONENT LIABILITY

LRC for remaining coverage;
LIC for incurred claims



Jan 2025

EFFECTIVE DATE (INDONESIA)

PSAK 117 mandatory for all
insurers per OJK, effective 1
Jan 2025



Under PSAK 117 (Indonesia's adoption of IFRS 17), the LRC under the General Measurement Model (GMM/BBA) is built from three building blocks: PVFCF, RA, and CSM.

The 3 Building Blocks of LRC



BUILDING BLOCK 1

PVFCF — Present Value of Future Cash Flows

Discounted best-estimate of all future cash **inflows** (premiums) and **outflows** (claims, expenses, acquisition costs), using IFRS 17 discount rates that reflect the time value of money and the characteristics of the liability.

1



BUILDING BLOCK 2

RA — Risk Adjustment for Non-Financial Risk

Compensation required for bearing **uncertainty** in the amount and timing of non-financial risks — including mortality, morbidity, lapse, and expense risk — beyond the best-estimate cash flows.

2



BUILDING BLOCK 3

CSM — Contractual Service Margin

Unearned profit deferred on the balance sheet at inception — set so that day-one P&L impact equals zero. Released to profit or loss over time as insurance coverage services are provided to policyholders.

3

IFRS 17 PARA 32–38

$$\text{LRC} = \text{PVFCF} + \text{RA} + \text{CSM}$$

FCF = PVFCF + RA | CSM at inception = $-(\text{FCF} + \text{cash flows at recognition date}) \rightarrow \text{Day-1 P\&L} = 0$

Step 1: Calculate the PVFCF

PRESENT VALUE OF FUTURE CASH FLOWS

FORMULA

$$\text{PVFCF} = \text{PV}(\text{Outflows}) - \text{PV}(\text{Inflows})$$

Zero-Profit Principle

Net of discounted claims, expenses & premiums



COMPONENT 01

Cash Inflows — Premiums

Premiums receivable from policyholders over the coverage period, within the contract boundary. Discounted at the IFRS 17 rate.

IFRS 17 PARA 36–37



COMPONENT 02

Cash Outflows — Claims & Expenses

Claims & benefits, directly attributable expenses, and allocated acquisition costs — all within the contract boundary.

IFRS 17 PARA 36–37



COMPONENT 03

Discount Rate — Two Approaches

Top-down: Asset yield minus illiquidity premium.

Bottom-up: Risk-free rate plus illiquidity premium. (Para B72–B85)

IFRS 17 PARA B72–B85



COMPONENT 04

Acquisition Costs — Special Treatment

Costs paid **before the recognition date** are included as cash outflows at the date of recognition — **not discounted** back.

IFRS 17 PARA 28A (2020)

Step 2: Calculate the Risk Adjustment (RA)

Compensation for bearing non-financial risk uncertainty — IFRS 17 para 37, B86–B92

IFRS 17 · LRC AT INCEPTION
No prescribed method — three common approaches

METHOD 01

Widely Used

%

Cost of Capital

CoC Approach

COC RATE

4% – 6%

COMPLEXITY

Moderate

- Analogous to Solvency II Risk Margin calculation
- Preferred by composite insurers (EY 2023)
- $RA = CoC\ rate \times SCR\ capital\ over\ coverage\ period$

METHOD 02

Most Common

📊

Value at Risk

VaR / Confidence Level

PERCENTILE RANGE

70th – 90th

COMPLEXITY

Low–Moderate

- Composite insurers: ~75th percentile (EY 2023)
- Life & Health: typically above 80th percentile
- P&C: 80th–90th percentile range common

METHOD 03

Least Common

📉

Tail VaR / CTE

TVaR / Conditional Tail Expectation

APPROACH

Stochastic

COMPLEXITY

High

- Average loss beyond a chosen confidence level
- Requires full stochastic scenario modelling
- More conservative; rarely adopted in practice



Disclosure Requirement: Regardless of method chosen, IFRS 17 requires the RA to be disclosed as an **equivalent confidence level** to enable comparability across entities. Source: IFRS 17 para B92; EY Research (2023); Addactis (May 2025).

Step 3: Calculate the CSM

FORMULA

$$\text{CSM} = - (\text{PVFCF} + \text{RA} + \text{Cash flows at recognition date})$$

Zero-Profit Principle

No P&L at inception for profitable contracts



RULE 01

Cannot Be Negative — Onerous Contract

If the CSM calculation yields a **negative value**, the contract is onerous and a **Loss Component** is recognised immediately in P&L at inception. No deferral is permitted.

IFRS 17 PARA 38 & 47–52



RULE 02

Locked-In at Inception

The CSM is measured using the **discount rate at the date of initial recognition**. This locked-in rate is fixed and does not change with subsequent market movements.

IFRS 17 PARA 44



RULE 03

Accretion of Interest Each Period

The CSM balance **accretes interest** at the locked-in inception discount rate each reporting period, reflecting the time value of money over the coverage period.

IFRS 17 PARA 44(B)



RULE 04

Release to P&L via Coverage Units

The CSM is released to profit or loss over the coverage period based on **coverage units** — reflecting the pattern of insurance contract services provided to policyholders.

IFRS 17 PARA 44–45

Numerical Example: 20-Year Whole Life Policy

IFRS 17 BBA (GMM) — LRC at Inception | Group of 1,000 Policyholders | No Cash Flows at Recognition

🛡️ WHOLE LIFE · 20-YEAR · \$200K DEATH BENEFIT

📌 **PRODUCT FACTS**
👥 1,000 policyholders, age 40
💚 PV claims (mortality + survival): **\$1,200,000**

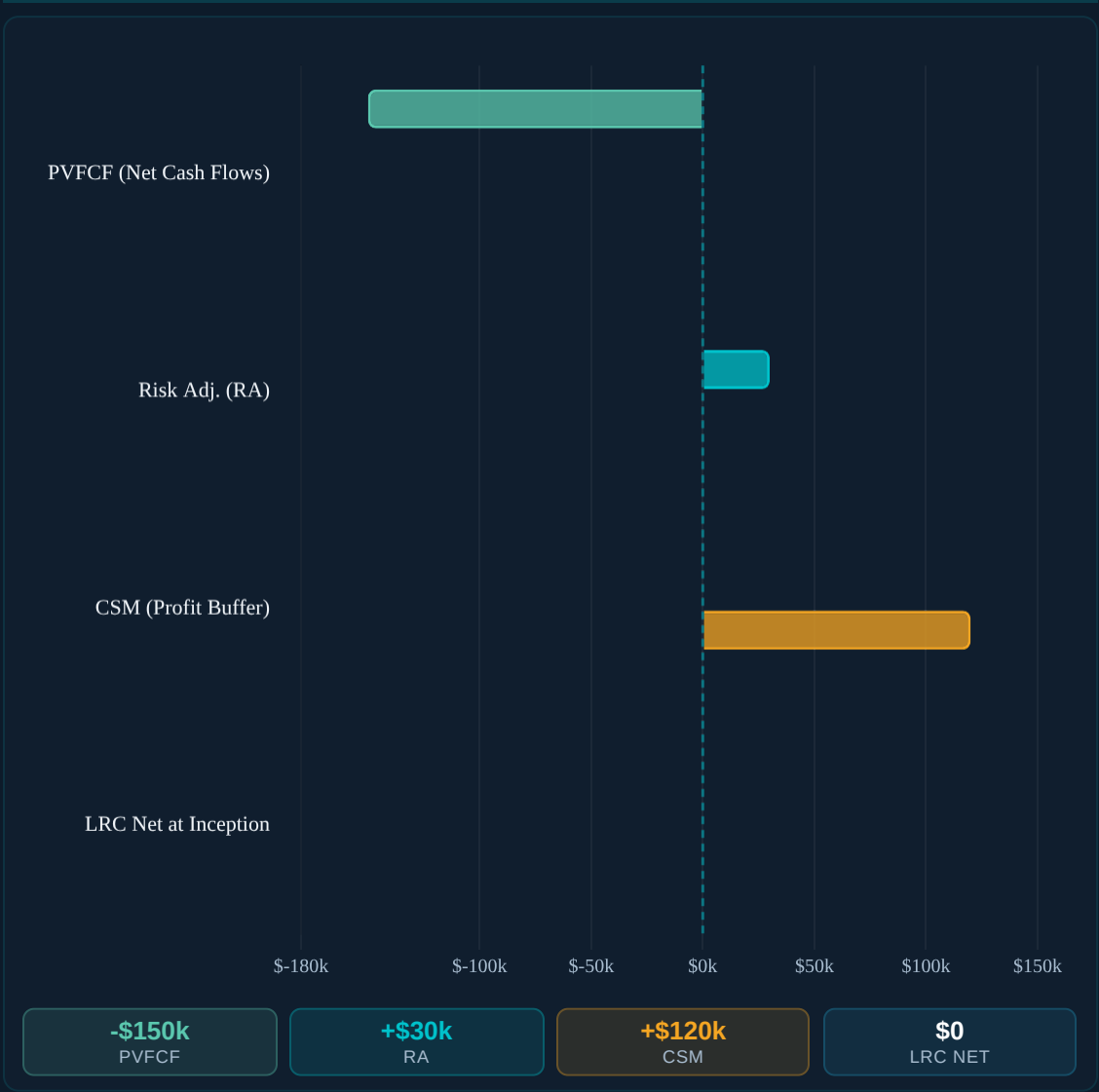
💵 Annual premium: **\$2,000/policy** → PV 20 yrs: **\$1,500,000**
📄 PV expenses: **\$150,000** | Acq. costs at recognition: **\$0**

📅 STEP-BY-STEP LRC CALCULATION AT INCEPTION

	COMPONENT	WHAT IT REPRESENTS	AMOUNT
1	PV Inflows	PV of 1,000 x \$2,000 annual premiums over 20 yrs	+\$1,500,000
2	PV Outflows	PV claims \$1,200k + PV expenses \$150k	-\$1,350,000
3	PVFCF	PV(Outflows) - PV(Inflows) = \$1,350k - \$1,500k	-\$150,000
4	Risk Adjustment (RA)	Mortality & longevity uncertainty (75th pct. VaR)	+\$30,000
5	Cash Flows at Recognition	No acquisition costs paid at inception date	\$0
6	CSM	$-(PVFCF + RA + \$0) = -(-\$150k + \$30k)$	+\$120,000
	LRC at Inception	$PVFCF + RA + CSM = -\$150k + \$30k + \$120k$	\$0 Net

💡 **Why GMM applies here:** The 20-year coverage period means cash flows must be **discounted** and updated each year. The CSM (\$120k) locks in the expected profit at inception — released over 20 years as coverage units are provided, not recognised upfront.

📊 LRC COMPONENT BREAKDOWN (\$'000)



Onerous Contracts: When CSM < 0

⚠ IFRS 17 | PARA 47–52

🔗 THE RULE

CSM $\geq$ 0 always

| When FCF > 0 → **Loss Component**

Zero-Floor Principle

CSM cannot be negative — losses recognised immediately



RULE 01

The Trigger — FCF > 0

When **Fulfilment Cash Flows are positive** (net liability before CSM), the group is onerous — expected losses exceed expected profits.

IFRS 17 PARA 47



RULE 02

CSM Cannot Be Negative

PSAK 117 / IFRS 17 **prohibits a negative CSM**. The CSM floor is zero — it can only defer profits, never absorb losses.

IFRS 17 PARA 38



RULE 03

Loss Component Established

The excess is recognised **immediately as a P&L loss**. A **Loss Component** is created within the LRC to track and release the onerous amount.

IFRS 17 PARA 47–52



RULE 04

Test at Every Reporting Date

Onerousness must be tested at **initial recognition** and at **every subsequent reporting date** — profitable groups can become onerous.

IFRS 17 PARA 47

Key Takeaways & What's Next

IFRS 17 · EPISODE 1 RECAP

LRC = FCF + CSM

The Liability for Remaining Coverage has three building blocks: Present Value of Future Cash Flows (PVFCF), Risk Adjustment (RA), and the Contractual Service Margin (CSM).

CSM is the Profit Buffer

The CSM is the balancing item that ensures zero net P&L at inception for profitable contract groups — expected profit is deferred and released over the coverage period.

Risk Adjustment Methods

Three approaches are permitted: VaR/confidence level (most common), cost of capital, or explicit probability-weighted scenarios. The RA reflects compensation for non-financial risk.

Onerous Contracts Rule

The CSM cannot be negative. When FCF exceeds zero at inception, a Loss Component is established and losses are recognised immediately in P&L — no deferral allowed.

EPISODE 2

COMING NEXT

How does the CSM unwind over the coverage period? — [Coverage Units & CSM Release Explained](#)

 Follow for Ep. 2  Like if helpful  Ask questions

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