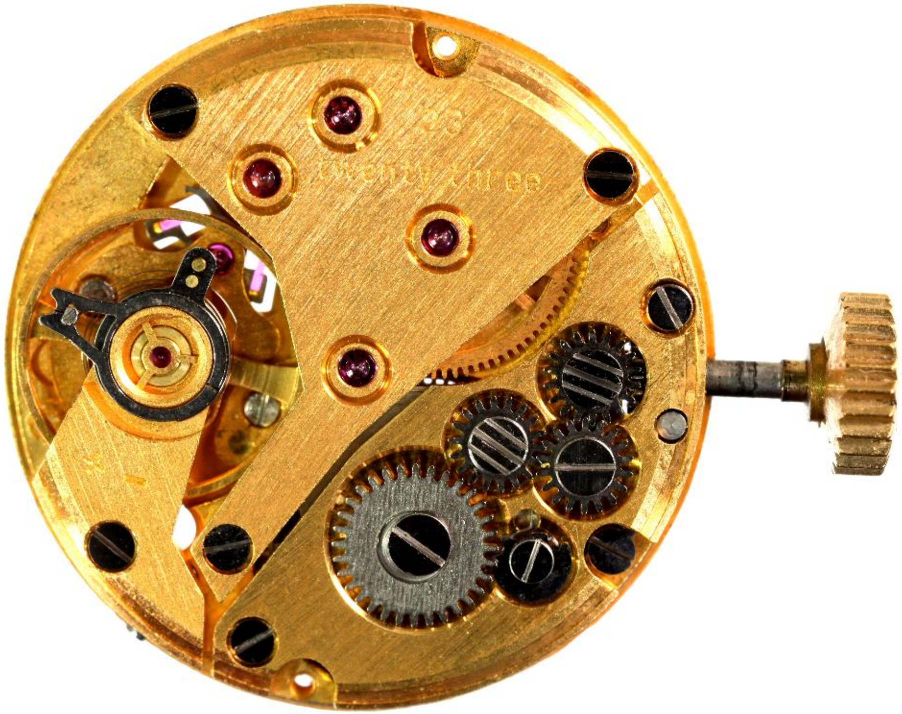

# The IASB clears the way towards IFRS 17 release

## Final sweep issues and guidance

**Francesco Nagari, Deloitte Global IFRS Insurance Leader | 2 March 2017**

# Agenda

- **Highlights of the IASB meeting on 22 February 2017**
- **IASB Staff analysis, IASB discussion and tentative decisions**
- **Next steps**

# Highlights of the IASB meeting on 22 February 2017

## Last meeting to discuss insurance contracts

- **The IASB Chairman emphasised that it will be the last time that the Board discusses insurance contracts prior to IFRS 17 publication**

## Changes to the Contractual Service Margin (CSM)

- **The IASB voted a new change to the original set of unlocking principles that determine which changes in the insurance liability unlock CSM and which ones go to P&L**
- **The new decision attempts to clarify where the dividing line is by revising the rules on unlocking across both the BBA and VFA**
- **A number of related definitions were also clarified as a result of this third and final attempt to clarify the treatment of experience adjustments and the unlocking of CSM**

## Grouping of regulatory-affected pricing of insurance contracts

– **The IASB agreed that when materially different levels of expected profit for contracts in the same portfolio are caused by regulatory constraints on pricing, the insurer is permitted to group them together as an exception to the general aggregation principle**

## External editorial review

– **Solutions for another 36 sweep issues arising from the external editorial review were approved unanimously**

# Changes to the Contractual Service Margin (CSM)

## Staff analysis

**Experience adjustments and the effect on estimated future cash flows**

***The IASB objective is to avoid the recognition of gain or loss in the current period due to the effect of experience adjustments and the impact on future estimate cash flows and a consequential gain or loss in future periods when a claim is incurred earlier or later than expected.***

**Current decision (November 2016)**

**The experience adjustment + related change in PV of future cash flows (combined) ð recognised in P&L**

- **However, the Staff identified that there are many insurance contracts in which there is no offsetting correlation between experience adjustments and future estimated cash flows. To require the identification of such situation would create undue operational complexity**

- **As such, the Staff believes it is more appropriate to reverse the November 2016 decision which required insurers to measure the experience adjustment and related changes in PV of future cash flows *together***

# Changes to the Contractual Service Margin (CSM)

## Staff analysis

### Definition of an experience adjustment

**Current decision**

**An experience adjustment equals the difference between:**

- ***Expected* incurred claims and expenses; and**
- ***Actual* incurred claims and expenses**

- **This definition does not exclude an investment component**

- **The Staff considers that a delay or acceleration in its repayment would lead to gain or loss in the related period (in profit or loss) that is automatically offset in future periods through the CSM release**

- **Consequently a change to the investment component does not have to be considered as an experience adjustment recorded in profit or loss**

## Changes to the Contractual Service Margin (CSM)

### Staff recommendation

- ***For contracts measured under the general model -*** **all changes in estimates of the present value of future cash flows arising from non-financial risks are adjusted against the CSM**

  – ***For contracts measured under the variable fee approach -*** **all changes in estimates of the present value of future cash flows that are unrelated to the underlying items and that arise from non-financial risks are adjusted against the CSM**

  – **Changes in estimates adjusted against the CSM include changes directly caused by experience adjustments. There are two exceptions: (i) where the change relates to incurred claims; and (ii) changes that trigger an onerous group loss or reverse a loss component**

  – **The definition of an experience adjustment will exclude investment components**

  – **The amount of the CSM for a group of insurance contracts recognised in profit or loss in each period is determined by allocating the carrying amount of the CSM after all other adjustments have been made to the carrying amount of the CSM <u>at the start of the period</u>**

# Changes to the Contractual Service Margin (CSM)

## IASB discussion and tentative decision

### General model - changes in estimates of future cash flows that are directly caused by experience adjustments

- There was general support for the Staff recommendation
- One Board member noted that there is no perfect solution given past decisions
- Another Board member expressed the view that the Staff recommendation provided a simple, easily understood solution

### General model - determination of the amount recognised in profit or loss to reflect the service provided in the period

- One Board member disagreed with the Staff recommendation as he felt that this would result in an inconsistent recognition of the amount of insurance revenue, which could have a significant effect on profit. Other members of the Board observed that they were personally supportive of the Staff recommendation
- One Board member noted the need to be clear about the treatment when changes in estimates are made subsequent to reporting interim results

# Changes to the Contractual Service Margin (CSM)

## IASB discussion and tentative decision

**Definition of an experience adjustment**

- **There was general support for the Staff recommendation**
- **Several Board members identified areas where the wording of the amended definition of an experience adjustment could be improved.**
- **The Staff will consider these suggestions in the final drafting work that would follow this Board meeting**

**Contracts measured under the VFA**

- **There was no Board discussion about this recommendation**

***Tentative decision***

– **All 12 Board members agreed with the Staff recommendations**

# Narrow exemption for grouping of regulatory-affected pricing of insurance contracts

## Staff analysis

**January 2016 decision: no exemption to level of aggregation when regulation constrains pricing or benefits**

- **There have been significant changes to the Board's decisions on the level of aggregation since January 2016**
- **Based on the recent decisions the aggregation could result in recognising onerous losses immediately for policyholders with a particular characteristic, whereas profits will be recognised over the coverage period for policyholders with a different characteristic**
- **Observers have pointed out that this may be hard to explain when risks are pooled in the same portfolio within which those two groups are created**

# Narrow exemption for grouping of regulatory-affected pricing of insurance contracts

## Staff recommendation

- **An entity is exempt from the requirement to divide a portfolio into groups of contracts – a group that is onerous on inception, not significantly likely to be onerous, and other contracts - if only, and only if, applying that requirement would result in the entity dividing the contracts of a portfolio into such groups because there are specific constraints in law or regulation on the entity's practical ability to set a price or benefit levels that vary according to policyholder characteristics**

- **When this is the case, the entity may include those contracts in the same group and should disclose that fact**

- **This exemption should not be extended by analogy to any other regulatory-affected transactions**

# Narrow exemption for grouping of regulatory-affected pricing of insurance contracts

## IASB discussion and tentative decision

- **There was general support for the Staff recommendation in the narrow circumstances described**
- **One Board member warned against providing too much detailed guidance, particularly as regulatory requirements often vary in different jurisdictions**

***Tentative decision***

- **Eleven Board members agreed with the Staff recommendation and one voted against it**

# Responding to the external editorial review

## Staff analysis

- **14 issues raised by both the Board members and the external reviewers that have resulted in the staff proposing a change from draft IFRS 17. In addition to the two issues presented in the previous pages we comment on another three of these issues**

- **15 clarifications to draft IFRS 17 that the Staff propose in the light of comments received on the draft. We comment on six of these issues**

- **9 further items which the Staff does not propose should be addressed as the Board has already considered these issues. We comment on two of these issues**

# Responding to the external editorial review

## Proposed changes from draft IFRS 17

- **Mutualisation – analysis**
  - **Guidance on how to account for insurance contracts with payments made to/ from other insurance contracts as a result of contractual requirements**
- **Mutualisation – recommendation**
  - **The basis of conclusions will clarify how these requirements interact with the requirement that only contracts issued within one year may be grouped**

# Responding to the external editorial review

## Proposed changes from draft IFRS 17

- **PAA: Investment components – analysis**
  - **Deletion of the requirement that the PAA may not be applied to contracts with an investment component**
- **PAA: Investment components – recommendation**
  - **Revenue arising under the PAA will also disaggregate investment components in a similar way to the general model**

# Responding to the external editorial review

## Proposed changes from draft IFRS 17

- **Contract boundary: Removing inconsistencies and frequency of assessment – analysis**
  - **A substantive obligation to provide coverage or other services ends when a price or level of benefits can be set that fully reflects the risks up to the date that these are reassessed**

- **Contract boundary: Removing inconsistencies and frequency of assessment – recommendation**
  - **An entity should reassess the boundary in each reporting period in the coverage period of the contract, to include the effect of changes in circumstances on its substantive rights and obligations**

## Responding to the external editorial review

### Proposed clarifications to draft IFRS 17

- **Level of aggregation: determining groups on day 1 – analysis**
  - **The draft IFRS 17 was ambiguous on the need to calculate BEL and RA at individual contract level in order to capture in a separate group all those contracts that would be loss making at initial recognition**

- **Level of aggregation: Recycling on de-recognition – recommendation**
  - **IFRS 17 will clarify that an insurer does not need to calculate the individual contract's BEL and RA at initial recognition if it can be certain that the resulting groups do not mix contracts with CSM with contracts without CSM (i.e. those that are individually onerous on day 1)**
  - **If an insurer does not have a method that achieves this objective it would have to calculate the contract's BEL and RA on an individual basis in order to the determine the groups on day 1**
  - **The prohibition to offset day one gains and losses is a key aspect of IFRS 17**

# Responding to the external editorial review

## Proposed clarifications to draft IFRS 17

- **Level of aggregation: Recycling on de-recognition – analysis**
  - **The draft IFRS 17 did not cover the process of recycling the accumulated OCI balance on derecognition of insurance contracts and this flaw needed to be rectified**

- **Level of aggregation: Recycling on de-recognition – recommendation**
  - **There will be two recycling processes in IFRS 17 when the OCI solution is utilised:**
    1. **Reclassify to profit or loss any remaining amounts for the group that were previously recognised in OCI because an effective yield or crediting rate approach was applied**
    2. **Should not reclassify to profit or loss any remaining amounts for the group that were previously recognised in OCI because a current book yield approach was applied**

# Responding to the external editorial review

## Proposed clarifications to draft IFRS 17

- **VFA criteria – analysis**
  - **Several reviewers recommended that IFRS 17 offers greater clarity on the first of the VFA criteria as it refers to "contractual terms" to identify a specific pool of underlying items given the IASB decision to add guidance that the sources of a contractual obligation can also include laws and regulations**

- **VFA criteria – recommendation**
  - **The final text of IFRS 17 will make applicable throughout the standard the guidance that explains the insurer's rights and obligations "arise from contract, law or regulation"**
  - **This guidance will be made consistent with IFRS 15**
  - **There is an extract of the new revised text in Appendix B of Paper 2C of the February 2017 IASB meeting**

## Responding to the external editorial review

### Proposed clarifications to draft IFRS 17

- **VFA simplified transition approach – analysis**
  - **Some reviewers recommended clarifications on the simplified transition approach for VFA when it is impracticable to restate prior periods**
- **VFA simplified transition approach – recommendation**
  - **A new text of paragraph C16 has been presented in paper 2C under item B9**
  - **The guidance clarifies how to use the fair value of the underlying items at transition date (i.e. 1/1/2020 for calendar year reporting entities), that only historical cash outflows that do not reduce the underlying items would need to be added back and the simplified calculation for the CSM released between the initial recognition of the contracts and transition date**

# Responding to the external editorial review

## Proposed clarifications to draft IFRS 17

- **Coverage units – analysis**
  - **Several reviewers recommended the inclusion of a definition of this important concept and the addition of guidance that would ensure a consistent application of the underlying principles**
- **Coverage units – recommendation**
  - **Guidance that the number of coverage units in a group is the amount of coverage provided by the contracts in the group, determined by considering for each contract the quantity of the benefits provided under the contract and its expected duration**

# Responding to the external editorial review

## Proposed clarifications to draft IFRS 17

- **Assumptions about inflation– analysis**
  - **Reviewers noted that there was ambiguity on the nature of assumptions regarding future inflation**
  - **This is important because only non-financial variable are considered in the unlocking of CSM while financial variables do not unlock the CSM other than for the financial variables associated with the underlying items identified in the VFA**
  - **In all other cases the changes caused by financial variables goes to P&L or OCI**

- **Assumptions about inflation – recommendation**
  - **Where inflation assumptions are based on an index of prices or rates or on prices of assets with inflation-linked returns they are *financial* assumptions**
  - **Where inflation assumptions are based on an entity's expectation of specific price changes they are *non-financial* assumptions**

# Responding to the external editorial review

## Proposed "no action" on the final text of IFRS 17

- **Locked-in accretion rate for CSM – analysis**
  - **Reviewers disagreed that the CSM for contracts accounted for other than using the VFA the insurer would need to accrete the time value of money on CSM utilising the discount rate set at initial recognition**
  - **IFRS 17 also requires that all of the CSM unlocking adjustments are calculated using this rate rather than the discount rate at the reporting date**

- **Locked-in accretion rate for CSM – recommendation**
  - **No change will be made on this matter given the balance of the CSM is not a future cash flow; and**
  - **The amounts that determined the CSM on day 1 are not updated for changes in discount rates other than in the VFA**

# Responding to the external editorial review

## Proposed "no action" on the final text of IFRS 17

- **Guidance on applying IFRS 17 to mutual insurers – analysis**
  - **Reviewers requested specific guidance for mutual insurers**
- **Locked-in accretion rate for CSM – recommendation**
  - **No specific guidance will be added in line with the approach for all IFRSs focus on guidance for the accounting of transactions rather than the entities that may have generated them**
  - **Educational initiatives and non-binding implementation guidance will be evaluated after IFRS 17 is published**

# Responding to the external editorial review

## IASB discussion and tentative decision

- The Staff asked only a general question as to whether the Board agree with the Staff proposals, and an issue was discussed only when requested by a Board member

- There was general support for the Staff recommendations, but several Board members identified areas where the proposed wording could be improved, notably for mutualisation, the VFA criteria and the meaning of "contractual terms"

*Tentative decision*

- All 12 Board members agreed with the Staff recommendations on the remaining sweep issues. Board members did not raise any other topics for consideration at a future meeting

## Insurance Contracts

### Next steps

- **The Staff will continue with the drafting process, reflecting the decisions made at this meeting in the ballot draft of IFRS 17**
- **The Staff expects to issue IFRS 17 in the first half of 2017**
- **The IASB Technical Plan released this week indicates that the expected publication date is May 2017**

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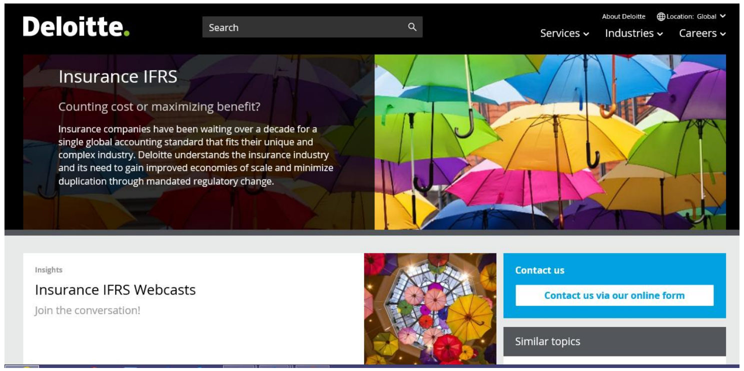

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