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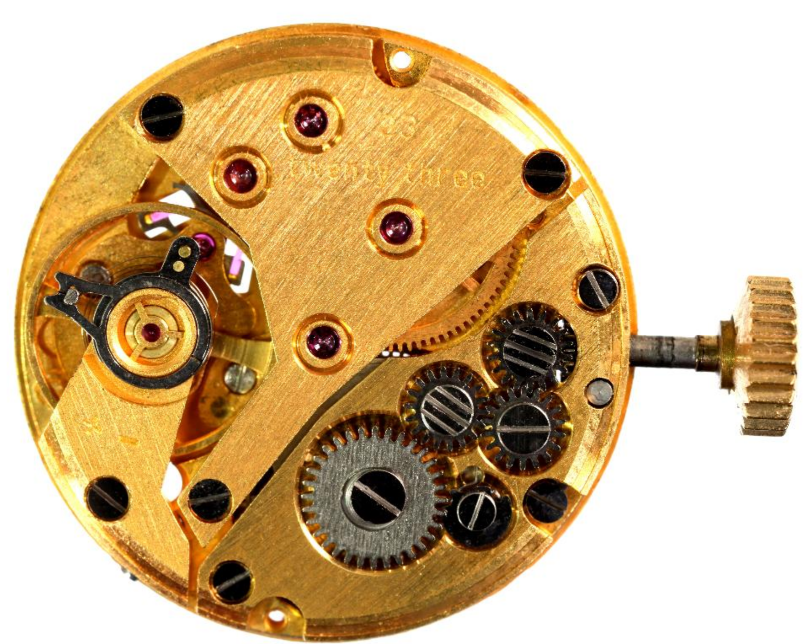

The IASB completes its third round of IFRS 17 amendments

IFRS 17 scope is trimmed for banks and transition for claims liability simplified

Francesco Nagari, Deloitte Global IFRS Insurance Leader | 21 February 2019

Agenda

- Highlights of the IASB meeting on 7 February 2019
- Detailed analysis of the IASB discussion and of the decisions reached
- Next steps

Highlights of the IASB meeting on 7 February 2019

- The IASB has continued the analysis of the 25 concerns identified for potential amendment at its October 2018 meeting when the criteria for assessing them were approved unanimously.
- The set of agenda papers for this meeting covered 4 concerns. Two have resulted in an approved amendment.
- The IASB has amended the scope of IFRS 17 and IFRS 9 such that insurance contracts for which the only insurance risk in the contract is from the settlement of some or all of the obligations created by the contract they could be designated to be accounted for under IFRS 9.
- The IASB has also amended the transition requirements in IFRS 17 for a liability that relates to the settlement of claims incurred before an insurance contract was acquired, by adding a specified modification to the modified retrospective approach to require an entity to classify such liabilities as a liability for incurred claims.
- One remaining concern, concern #2 "level of aggregation", will be covered in the IASB meetings in March 2019. A question about a risk mitigation option for general model contracts will also be addressed in the meeting.

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Loans that transfer significant insurance risk

1—Scope of IFRS 17 | Loans and other forms of credit that transfer insurance risk

- IFRS 17 applies to all insurance contracts as defined in IFRS 17, regardless of the type of entity issuing the contracts, with some specific exceptions.
- IFRS 17 prohibits the separation of non-insurance components from an insurance contract if the specified unbundling criteria are not met.
- Permitting separation of non-distinct non-insurance components would result in less useful information and would reduce the comparability of the financial statements across entities.
- Stakeholders are concerned that IFRS 17 requires entities to account for some loans that transfer significant insurance risk as insurance contracts in their entirety. Examples such as mortgage with death waiver, lifetime mortgage contract, student loan contract where repayments are income contingent, all fall in this category.
- Stakeholders are concerned that entities issuing such contracts would need to incur unnecessary costs to apply IFRS 17.
- Stakeholders also believed that it would be more appropriate to account for these contracts partially or totally applying IFRS 9.

Do you agree that the Board amends the scope of IFRS 17 and IFRS 9 for insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligations created by the contract to enable an entity to apply either IFRS 17 or IFRS 9 to such contracts that it issues?

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Loans that transfer significant insurance risk

1—Scope of IFRS 17 | Loans and other forms of credit that transfer insurance risk

- The Staff acknowledged that there might be significant costs to implement IFRS 17, without corresponding benefits, for entities that only issue insurance contracts where risk comes from the settlement of some or all of the obligations under the contract. Applying IFRS 9 to such contracts would provide useful information to financial statements users.
- The Staff has considered possible ways of amending IFRS 17 as follows:
  - Approach 1—Separating the loan from an insurance contract
  - Approach 2 – Excluding from the scope of IFRS 17 insurance contracts for which the only insurance risk in the contract is from the settlement of some or all of the obligations created by the contract
    - Approach 2A - A requirement that entities exclude from the scope of IFRS 17 such contract
    - Approach 2B - An option that permits entities to apply either IFRS 17 or IFRS 9 to such contract
- The Staff noted that amending IFRS 17 to permit an entity to apply IFRS 17 or IFRS 9 to a specified population of insurance contracts would address the concerns and implementation challenges without unduly impairing comparability.
- The Staff recommended approach 2B to the Board
- Possible implications to transition and disclosure requirements will be considered at a future meeting.
- The Board tentatively voted 13:1 to agree with the Staff's recommendation to amend the Standard on a portfolio basis.

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Transition – Optionality and comparative information

23—Transition | Optionality

- An entity is required to apply IFRS 17 retrospectively, unless impracticable.
- If a full retrospective application is impracticable, IFRS 17 permits an entity to choose between the modified retrospective approach and the fair value approach. The choice is made on a group-by-group basis.
- Stakeholders are concerned that the optionality and availability of different transition approaches could reduce comparability of entities' performance after the date of transition, potentially for a number of years; and result in a loss of trend information for some groups of insurance contracts.

Do you agree that the Board should retain the IFRS 17 transition requirements, without amendment that would reduce the optionality included in those requirements?

- Amending the transition requirements would not meet the criteria for amending IFRS 17 set by the Board at its October 2018 meeting as it may unduly disrupt implementation underway; and the transition requirements were developed based on prior feedback that the Board has received on transition approaches.
- IASB Staff concluded that the Board should retain the transition requirements in IFRS 17, without amendments that would reduce the optionality included in those requirements.
- The Board voted unanimously to tentatively agree with the Staff recommendation not to amend the Standard.

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Transition – Optionality and comparative information

23—Transition | Comparative information

- IFRS 17 requires an entity to restate comparative information about insurance contracts for the annual reporting period immediately preceding the date of initial application, on initial application of IFRS 17.
- IFRS 17 permits, but does not require, an entity to present adjusted comparative information applying IFRS 17 for any earlier periods presented.
- Some stakeholders are concerned that the time to implement IFRS 17 before its effective date would be insufficient and suggested that the Board permits entities not to present adjusted comparative information when applying IFRS 17.
- Some stakeholders noted that financial statements that restate comparative information about insurance contracts, but do not restate financial assets, could distort users' understanding of those entities' economic circumstances and transactions, both in prior periods and the current period.
- Accounting mismatches may be reported in the comparative period between insurance contracts and related financial assets. The net financial position and profit reported in the comparative period would not be comparable to that reported in the current reporting period.
- Some stakeholders also noted the different approach to restating comparative information applying the transition requirements of IFRS 9.

Do you agree the Board should retain the IFRS 17 requirement to present restated comparative information for the annual reporting period immediately preceding the date of initial application of IFRS 17?

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Transition – Optionality and comparative information

23—Transition | Comparative information

- IASB Staff noted that the Board has already tentatively decided to defer the effective date of IFRS 17 by one year. This gives entities a further year to prepare comparative information.
- The reasons for which the Board decided to require entities to restate comparative information for insurance contracts, but not for financial assets, are still valid. IASB Staff noted that an entity can:
  a) avoid accounting mismatches because it is permitted, but not required, to restate comparative information applying IFRS 9 if it is possible without hindsight; and
  b) start collecting the necessary information now to apply IFRS 9 without hindsight.
- IASB Staff thought that permitting entities not to present adjusted comparative information when first applying IFRS 17 would increase the complexity for users of financial statements and, therefore, would cause significant loss of useful information.
- Permitting entities not to present adjusted comparative information when first applying IFRS 17 would increase the difficulty of investors and analysts understanding the IFRS 17 transition.
- IASB Staff recommended no change to IFRS 17.
- The Board voted unanimously to tentatively agree with the Staff recommendation not to amend the Standard.

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Transition – Risk mitigation option and amounts accumulated in other comprehensive income on transition

8—Measurement | CSM: limited applicability of the risk mitigation exception – transition

- IFRS 17 introduced a form of hedge accounting for insurance contracts accounted for under the VFA. This is referred as the "risk mitigation option". Initial discussion took place in December 2018 and in January 2019.
- IFRS 17 requires prospective application of the risk mitigation option from the date of initial application of the Standard to avoid the risk of hindsight, consistent with the IFRS 9 hedge accounting transition requirements.
- Stakeholders are concerned that a CSM that does not reflect risk mitigation activities from previous periods may distort equity of entities on transition and the revenue recognised for these groups of contracts in future periods.
- Stakeholders suggested the Board should amend the transition requirements one of the ways:

a) allow entities to apply the risk mitigation option fully retrospectively, or prospectively from the transition date rather the date of initial application;
b) allow entities to choose to apply the risk mitigation option retrospectively provided that they can demonstrate that they met the IFRS 17 requirements without hindsight; or
c) similar to (b) above, except that the entity would be mandated to use the risk mitigation when the IFRS 17 requirements are met without hindsight.

Do you agree that the Board should retain the requirements in IFRS 17 relating to the prohibition of retrospective application of the risk mitigation option on transition to IFRS 17?

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Transition – Risk mitigation option and amounts accumulated in other comprehensive income on transition

8—Measurement | CSM: limited applicability of the risk mitigation exception – transition

- Staff noted that applying the risk mitigation option retrospectively without using hindsight is challenging because:
  a) Entity would have to determine what amounts it would have recognised in profit or loss for the mitigated risks;
  b) Retrospectively applying an option that is prospective by nature gives rise to 'cherry picking' opportunities.
  c) Unjustified inconsistency with IFRS 9 hedge accounting requirements.
- IASB Staff noted that **the use of hindsight in retrospective application of the risk mitigation option would significantly reduce the value of risk mitigation activities information**.
- Prospective application of the risk mitigation option reflects management decisions in the most neutral way hence provides the most useful information to financial statements users.
- The Staff noted that allowing entities to choose to which relationships to apply the risk mitigation option with the benefit of hindsight on their effect effectively enables entities to choose the amount of the CSM on transition and thus the future profit to be recognised in profit or loss.
- The Staff recommend that the Board retain the requirements in IFRS 17 relating to the prohibition of retrospective application of the risk mitigation option as it would cause significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements.
- The Board tentatively voted 13:1 to agree with the Staff's recommendation not to amend the Standard. IASB Staff will do further research and bring back the issue at a future meeting.

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Transition – Risk mitigation option and amounts accumulated in other comprehensive income on transition

25—Transition | Fair value approach: OCI on related financial assets

- An insurer, when choosing to disaggregate insurance finance income or expenses between profit and loss and OCI, may be permitted or required to determine the cumulative amount of insurance finance income or expenses recognised in OCI at the transition date as nil under specified circumstances.
- An insurer is permitted to apply the specified modifications only to the extent that an entity does not have reasonable and supportable information to apply a retrospective approach.
- Stakeholders raised concerns that the outcome of applying the transition requirements of IFRS 17 would result in determining the accumulated amount of insurance finance income or expenses recognised in OCI as nil, while the amount accumulated in OCI for the related assets would not be nil, which could significantly distort equity composition on transition to IFRS 17.

Do you agree that the Board should retain the requirements in IFRS 17 with respect to the cumulative amounts included in other comprehensive income on transition to IFRS 17?

Transition – Risk mitigation option and amounts accumulated in other comprehensive income on transition

25—Transition | Fair value approach: OCI on related financial assets

- Permitting entities to deem the cumulative amount in OCI related to corresponding assets as nil at transition to IFRS 17, would involve an amendment to IFRS 9 and it would make the transition requirements in IFRS 9 more complicated which significantly reduce the comparability of related information.
- The Staff noted that with a resetting of the accumulated OCI there would also be an inconsistency in the accounting for expected losses from financial assets at FVOCI.
- The Staff also noted that permitting entities to deem the cumulative amount of insurance finance income or expenses recognised in OCI for insurance contracts at transition to be the same amount as the cumulative amount in OCI relating to related assets would affect the insurance finance income or expense that will be recognised in future reporting periods.
- This option is only available for VFA contracts when underlying items are held (paragraph C18(b)(ii)).
- The Staff recommended no amendment to IFRS 17.
- The Board voted unanimously to tentatively agree with the Staff recommendation.

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Transition – Modified retrospective approach

24—Transition | Modified retrospective approach: further modifications

- An entity may choose to either apply the modified retrospective approach (MRA) or the fair value approach (FVA) for that group of insurance contracts if it is impracticable to apply full retrospective approach (FRA).
- An entity can apply the specified modification only:
  a) to the extent ***it does not have reasonable and supportable information*** to retrospectively apply the IFRS 17 requirements to which that modification relates; and
  b) if it has reasonable and supportable information to apply that modification.
- Stakeholders stated that it is difficult to interpret the term ***'reasonable and supportable information'*** and they may struggle to prove the data they want to use can be reasonable and supportable.
- 'Reasonable and supportable information ***available without undue cost or effort***' was also questioned.

Do you agree the Board should retain the requirements in IFRS 17 that an entity:

(a) cannot use a specified modification in the modified retrospective approach to the extent that the entity has reasonable and supportable information to apply the related IFRS 17 requirement retrospectively; and

(b) can only use a specified modification in the modified retrospective approach when the entity has reasonable and supportable information to apply that modification.

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Transition – Modified retrospective approach

24—Transition | Modified retrospective approach: further modifications

- The Staff acknowledged that determining whether information is reasonable and supportable when transitioning to IFRS 17 may require an assessment and careful consideration.
- The Staff acknowledged that the amendment that the entity be permitted to use each specific modification even when the reasonable and supportable information is available could provide significant practical relief to entities transitioning to IFRS 17. However, the Staff concluded that to allow an entity to ignore its ability to retrospectively apply specific requirements in IFRS 17 is not justified and would result in an unacceptable loss of useful information.
- Staff also noted that allowing an entity to apply a specified modification without having reasonable and supportable information to do so would be inappropriate.

Full retrospective approach (FRA)

- If an entity has reasonable and supportable information.

Modified retrospective approach (MRA)

- In the absence of reasonable and supportable information for full retrospective approach.
- Specified modifications to be applied using the reasonable and supportable information, that is available without undue cost or effort, as a proxy for full retrospective approach.

Fair value approach (FVA)

- In the absence of reasonable and supportable information for full and modified retrospective approaches.
- A combination of fair value and modified retrospective approach is not permitted to be applied in the same group of insurance contracts.

Transition – Modified retrospective approach

24—Transition | Modified retrospective approach: further modifications

- With regards to the term **'available without undue cost or effort'** in IFRS 17 paragraph C6, the IASB Staff explained it as below:

  a) Modifications in the MRA were developed in order to achieve the closest outcome to the FRA application using information available without undue cost or effort.
  b) By nature, the information for MRA would likely be easier and less costly to obtain than that for FRA. An entity is allowed to devote as much cost and time to get that information.
  c) The use of pieces of information that would be compliant with the FRA shall be maximized.
  d) This term is not relevant in IFRS 17 paragraph C8.

- The Staff recommended that the Board retain the requirements in IFRS 17 that an entity
  a) cannot use a specified modification in the MRA to the extent that the entity has reasonable and supportable information that would have been used under the FRA.
  b) can only use a specified modification in the MRA when the entity has reasonable and supportable information to apply that modification

- The Board voted unanimously to tentatively agree with the Staff recommendation not to amend the Standard.

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Transition – Modified retrospective approach

24—Transition | Modified retrospective approach: further modifications

- Stakeholders expressed the view that the MRA is too restrictive, making it costly and burdensome to apply in practice. Restrictions on prohibiting insurers from making estimates that are necessary to retrospectively apply IFRS 17 to those requirements to which the entity does not apply the specified modifications are particularly burdensome.
- Some stakeholders expressed the view that the MRA does not provide sufficient specified modifications.
- Stakeholders have suggested the Board amend IFRS 17 to permit the use of a principle-based approach that will allow to develop “ad hoc” modifications as long as they are consistent with the objective of the MRA.
- Stakeholders have also suggested the amendments for the following topics which will address some of the concerns raised by them:

  a) Contracts acquired in their settlement period before transition
  b) Cash flows that are known to have occurred
  c) Insurance contracts with direct participation features

Transition – Modified retrospective approach

24—Transition | Modified retrospective approach: further modifications

Do you agree the Board should:

a) not amend IFRS 17 to permit an entity to develop its own modifications that it regards as consistent with the objective of the modified retrospective approach.

b) amend the transition requirements in IFRS 17 for a liability that relates to the settlement of claims incurred before an insurance contract was acquired as follows:

   i. to add a specified modification to the modified retrospective approach to require an entity to classify such liabilities as a liability for incurred claims. Consistent with the other specified modifications, an entity would be permitted to use this specified modification only to the extent that it does not have reasonable and supportable information to apply a retrospective approach.

   ii. to permit an entity applying the fair value approach to choose to classify such liabilities as a liability for incurred claims.

c) does not amend the specified modification in the modified retrospective approach related to the use of cash flows that are known to have occurred instead of estimating retrospectively cash flows that were expected to occur.

d) does not amend IFRS 17 to permit an entity to apply the specified modifications related to groups of insurance contracts without direct participation features to determine the contractual service margin for groups of contracts with direct participating features.

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Transition – Modified retrospective approach

24—Transition | Modified retrospective approach: further modifications

Permitting entities to develop their own additional modifications

- The objective of using specified modifications in the MRA is to arrive at the outcome closest to the FRA.
- The Staff noted that by permitting the entity to form its own unspecified additional modifications would create a risk that the final outcome would not meet the objective of approximating the FRA.
- IASB Staff recommended the Board not to amend IFRS 17 to permit an entity to develop its own modifications that the entity regards as consistent with the objective of the MRA.
- The Board voted unanimously to tentatively agree with the Staff recommendation not to amend the Standard.

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Transition – Modified retrospective approach

24—Transition | Modified retrospective approach: further modifications

Contracts acquired in their settlement period before transition

- Acquired Liabilities for Incurred Claims (LIC) under IFRS 17 would have a CSM balance and would be classified as Liabilities for Remaining Coverage (LRC) in the books of the buyer.
- On transition, both MRA and FVA do not address the classification of amounts as a liability for remaining coverage or liability for incurred claims when they arise from insurance contracts acquired.
- Staff noted that due to the way entities often manage LIC it is often impractical to distinguish between LIC arising from different insurance contracts issued, acquired before and after the transaction date.
- The Staff recommended the Board amend the transition requirements in IFRS 17 for acquired LIC as below:
  a) To add a specified modification to the MRA to require an entity to classify such liabilities as a LIC thus without a CSM balance.
  b) To permit an entity applying the FVA to choose to classify such liabilities as LIC thus without a CSM balance.
- The Board voted unanimously to tentatively agree with the Staff recommendation.

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Transition – Modified retrospective approach

24—Transition | Modified retrospective approach: further modifications

Cash flows that are known to have occurred

- The Staff noted that, with reference to IAS 8 paragraph 51, making estimates is more difficult when retrospectively applying an accounting policy because of the period of time that might have passed since the transaction or event being measured.
- According to IFRS 17 paragraph C6, if data on actual cash flows has not been collected or has been collected at a different level than required, an entity is required to use reasonable and supportable information to estimate those amounts.
- The Staff recommended the Board not to amend paragraph C12 of IFRS 17 with respect to cash flows that are known to have occurred but to write some comments in the Basis for Conclusions.
- The Board voted unanimously to tentatively agree with the Staff recommendation not to amend the Standard.

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Transition – Modified retrospective approach

24—Transition | Modified retrospective approach: further modifications

Insurance contracts with direct participation features

- The Staff noted that the specified modification for VFA contracts are intended to enable entities to determine directly the CSM at transition date whereas the specified modifications for general model contracts are designed to first estimate the CSM at initial recognition and then to roll forward the contractual service margin at transition date.
- It is highly unlikely that applying the specified modifications applicable to general model contracts to VFA contracts would provide an outcome that is closer to the outcome that would result from applying the transition requirements in IFRS 17 for VFA contracts.
- The Staff therefore recommended the Board not to amend the requirements of IFRS 17 to permit an entity to apply the specified modifications related to groups of insurance contracts without direct participation features to determine the CSM for groups of contracts with direct participation features.
- The Board voted unanimously to tentatively agree with the Staff recommendation not to amend the Standard.

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Next steps

IASB

- The IASB will discuss one remaining concern (level of aggregation) and any sweep issues over its meeting during the week beginning on 11 March 2019.
- The next TRG meeting will be held on 4 April 2019 in the IASB office in London.
- The IASB Technical Plan states that the ED amending IFRS 17 will be published by the end of Q2 2019
- The Due Process Oversight Board has agreed to a short comment period (less than 120 days) for the responses to the questions in the upcoming ED.

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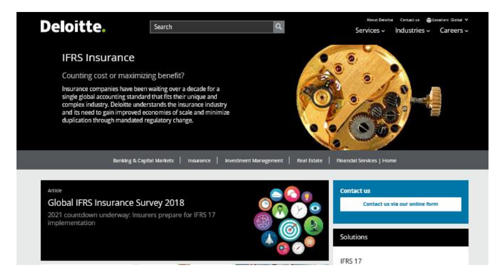

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