

The IASB completes its second round of IFRS 17 amendments Major fixes on profit recognition principles approved

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Agenda

- Highlights of the IASB meeting on 23 January 2019
- Detailed analysis of the IASB discussion and of the decisions reached
- Next steps

Highlights of the IASB meeting on 23 January 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 5 concerns. Four have resulted in an approved amendment.
- The IASB has rectified the requirements for profit recognition in the event an insurance contract provides the policyholder with insurance services and other non-insurance services related to an investment management activity. IASB approved that both services must be considered in IFRS 17 profit recognition through the CSM.
- The IASB has amended the application of the pre-coverage acquisition cash flows allowing the deferral of acquisition costs incurred with the expectation of future contract renewals
- Cedant accounting was rectified in a few areas addressing the alleged mismatch between reinsurance recoveries and onerous losses and allowing reinsurance held to be used as a hedging instrument for VFA hedge accounting.
- The IASB confirmed that the exclusion of reinsurance contracts from the VFA accounting would not change.
- 4 out of the remaining 6 concerns will be covered in the IASB meetings in February 2019 as of today. 3 of these have been highlighted by the IASB Staff as concerns where valid amendments could be passed. The last two concerns are concern 2 "level of aggregation" and concern 25 "Transition | Fair value approach: OCI on related financial assets"

Recognition of the contractual service margin in profit or loss in the general model

7—Measurement | Contractual service margin: coverage units in the general model

- At the June 2018 Board meeting, it was tentatively decided to clarify that the determination of coverage units should be determined by considering both insurance coverage and investment-related services to be consistent with the VFA.
- Concerns were noted:
 - a. **Insurance contracts that are not direct participating contracts provide investment-related services or other services and these services should be reflected in the coverage units applied for the CSM allocation** of those contracts
 - b. CSM is determined based on all the expected cash flows discounted at a current market-consistent rate. Effect of difference between the expected return on an investment component promised to a policyholder and the market rate for such returns is included. This difference in CSM was considered to be recognized in P&L
 - c. **Without reflecting the investment-related services in the determination of coverage units would result in unintended consequences**

Recognition of the contractual service margin in profit or loss in the general model 7—Measurement | Contractual service margin: coverage units in the general model

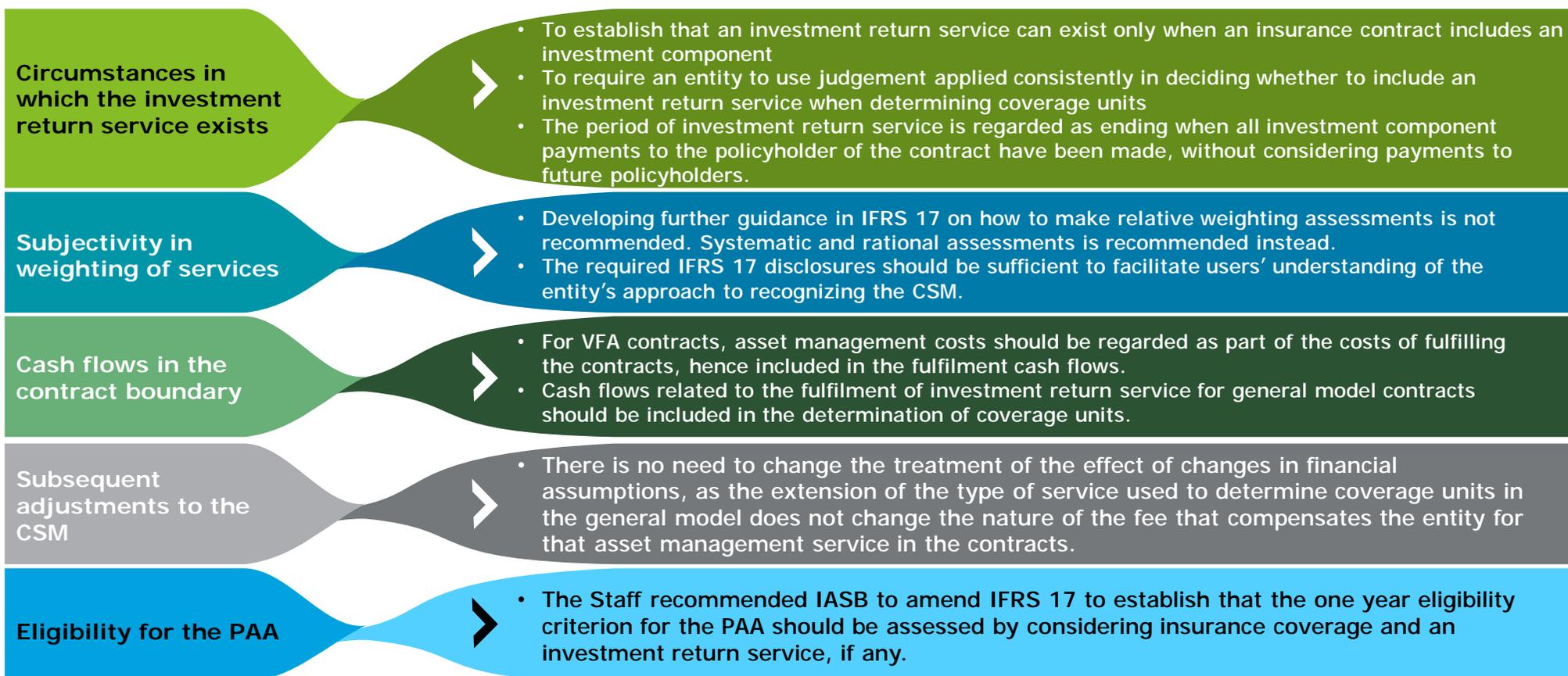
- Insurance contracts **with** direct participation features—for which the entity is regarded as **providing a service equivalent to asset management**.
- Insurance contracts **without** direct participation features—for which the entity is **providing a return that reflects the uncertainty of the cash flows to be repaid to the policyholder**, just like any financial liability.
- It was acknowledged that **no useful information is provided** for contracts that have an insurance coverage period that differs from the period in which the **policyholder gets return on an investment component if the total profit is recognized over only the insurance coverage period**.
- **“Investment return service”** is providing the policyholder with access to an investment return that would not otherwise be available to the policyholder, i.e. instead of managing assets on behalf of the policyholders.
- The Staff **recommended the IASB to amend IFRS 17** so that in the general model the **CSM is allocated on the basis of coverage units that are determined by considering both insurance coverage and any investment return service**.

Do you agree the Board amend IFRS 17 so that in the general model the contractual service margin should be allocated on the basis of coverage units that are determined by considering both insurance coverage and any investment return service?

Recognition of the contractual service margin in profit or loss in the general model

7—Measurement | Contractual service margin: coverage units in the general model

- The IASB Staff identified a number of IFRS 17 amendment recommendation relating to the determination of coverage units based on insurance coverage and an investment return service:



Recognition of the contractual service margin in profit or loss in the general model

7—Measurement | Contractual service margin: coverage units in the general model

- The Staff thought the recognition of the CSM in profit or loss is a fundamental aspect of the depiction of the performance of groups of insurance contracts.
- The Staff acknowledged that there is inevitable subjectivity in determining the pattern of provision of service, where there are two key services provided by insurance contract without direct participation features as insurance coverage and investment return service.
- Using these two services as the basis for the CSM recognition will provide more useful information without introducing more subjectivity by allowing for other services.
- The benefits outweigh the costs of including an investment return service in the determination of coverage units. Differences between the general model and the VFA could be reduced, as the differences in the CSM recognition pattern in P&L would be reduced.
- A widespread effect is expected with such amendment as there is a large number of insurance contracts with investment components. However, this can be justified given that more useful information made available to users.
- The Board **tentatively voted 13:1** to agree with the Staff's recommendation to amend the Standard.

Insurance acquisition cash flows for renewals outside the contract boundary

3—Measurement | Acquisition cash flows for renewals outside the contract boundary

- Entities pay commission for new contracts where renewals are expected in the future. Commissions, in some cases, are higher than the premium an entity charges for the new contract. Cash flows related to renewals arising from newly issued insurance contracts are outside the boundaries of the newly issued contracts.
- Insurance acquisition cash flows include both acquisition costs paid at the contract inception and recurring commissions that are expected to be paid to intermediaries within the contract boundary. Cash flow expectations reflect the extent to which amounts are refundable.
- Insurance acquisition cash flows **should not be depicted as a separate recognized asset**. Including insurance acquisition cash flows in the fulfilment cash flows of a group of contracts results in the measurement of the insurance contract being a faithful representation of the obligation to pay for insured losses.
- The measurement model in IFRS 17 **captures any lack of recoverability of insurance acquisition cash flows** for a group of insurance contracts i) at initial recognition of a group of contracts and ii) over time.
- Recoverability of insurance acquisition cash flows is not necessary to be separately tested for impairment.

Insurance acquisition cash flows for renewals outside the contract boundary

3—Measurement | Acquisition cash flows for renewals outside the contract boundary

- The amount that relates to the insurance acquisition cash flows is allocated to each reporting period in a systematic way on the basis of passage of time. The same amount is recognized as revenue and insurance service expenses as coverage is provided. The **effect of insurance acquisition cash flows on profit is captured in the measurement and allocation of the contractual service margin.**

Do you agree the Board amend IFRS 17 to require an entity to:

- a. allocate to any anticipated contract renewals part of the insurance acquisition cash flows directly attributable to newly issued contracts.
- b. recognise the insurance acquisition cash flows allocated to anticipated contract renewals as an asset according to IFRS 17 para. 27 until the renewed contracts are recognised.
- c. assess the recoverability of the asset recognised according to IFRS 17 para. 27 each period before the related contracts are recognised. The recoverability assessment would be based on the expected fulfilment cash flows of the related group of contracts.
- d. recognise a loss in profit or loss for any unrecoverable carrying amounts of the asset recognised by applying IFRS 17 para. 27
- e. recognise in profit or loss the reversal of some or all of any such loss previously recognised when the impairment conditions no longer exist or have improved.

Insurance acquisition cash flows for renewals outside the contract boundary

3—Measurement | Acquisition cash flows for renewals outside the contract boundary

- The requirements of IFRS 17 result in the recognition of a loss in the circumstances described
 - a. the entity **does not have any guarantee of recoverability** from the agent.
 - b. although the entity expects it will recover the non-refundable commission from expected contract renewals, the **cash flows related to these contract renewals do not arise from existing substantive rights and obligations** of the entity.
- Recognizing a loss in these circumstances would be similar to recognizing a loss in circumstances that the entity sells newly issued contracts at a significant discount in anticipation of future contract renewals.
- The Staff observed that economic substance of the transactions may not be reflected from applying these IFRS 17 requirements and IFRS 17 may differ from what may be achieved in arguably similar circumstances by applying IFRS 15.
- If, applying IFRS 15 to the circumstances in paragraph 25, the entity recognised an asset for the non-refundable commission, the commission would not cause the contract to be onerous. The non-refundable commission would be amortised over a period including anticipated renewal periods of the contract, provided that it can be recoverable.
- The IASB Staff noted that the requirements of IFRS 15 for incremental costs of obtaining a contract that relate to an anticipated contract renewal are not directly comparable to the requirements in IFRS 17. The IASB Staff however noted that IFRS 17 requirements should be considered in a way to align more closely with IFRS 15 requirements.

Insurance acquisition cash flows for renewals outside the contract boundary

3—Measurement | Acquisition cash flows for renewals outside the contract boundary

- The IASB Staff considered and rejected the alignment of all insurance acquisition cash flows as defined in IFRS 17 with all the requirements of IFRS 15 related to incremental costs to obtain a contract; and changing the contract boundary
- The Staff thought that the Board should not develop specific requirements on how to allocate part of the insurance acquisition cash flows to anticipated contract renewals.
- The Staff thought that it is possible to amend IFRS 17 to require an entity to:
 - a. **allocate to any anticipated contract renewals part of the insurance acquisition cash flows that are directly attributable to newly issued contracts**, resulting in the entity recognising that as an asset as per IFRS 17 para. 27
 - b. **assess the recoverability** of that asset on a group of insurance contracts basis, based on the fulfilment cash flows of the related contracts, each period before the related contracts are recognized.
 - c. **recognize a loss in profit or loss for any unrecoverable carrying amounts of the asset recognized** for any insurance acquisition cash flows before the group of contracts is recognized per IFRS 17 para. 27.
 - d. **recognize in profit or loss the reversal** of some or all of such loss previously recognized when the impairment conditions no longer exist or have improved
- The Board **tentatively voted 13:1 to agree with the Staff** recommendation to amend the Standard.

Reinsurance contracts held—onerous underlying insurance contracts

12—Measurement | Reinsurance contracts held: initial recognition when underlying insurance contracts are onerous

- For reinsurance contracts held, the cedant **receives services** from the reinsurer. The CSM, instead of representing unearned profit for insurance contracts issued, it represents the **net cost/gain of purchasing reinsurance**.
- This CSM is therefore can be a in a net cost or net gain position, and is recognized over the coverage period as services are received.
- There is one exception relating to the CSM adjustments for reinsurance contracts held, i.e. exception relating to situations when an underlying group of insurance contracts becomes onerous after initial recognition due to adverse changes in estimates of fulfilment cash flows.
- **To the extent that there are corresponding changes in estimates of fulfilment cash flows for the reinsurance contracts held, CSM is not adjusted, but instead recognized in P&L.** This is an exception added in response to a concern raised in regards to the 2013 Exposure Draft.

Reinsurance contracts held—onerous underlying insurance contracts

12—Measurement | Reinsurance contracts held: initial recognition when underlying insurance contracts are onerous

- This scope of the exception was considered to be too narrow
- Accounting mismatch arises when
 - a. The underlying contracts are onerous at initial recognition where a loss has to be immediately recognized in P&L, and a gain in reinsurance contract held is recognized even if the cash flows of the reinsurance contract held match those of the underlying insurance contracts;
 - b. A reinsurance contract held is in a net cost position and covers both onerous and profitable groups of underlying insurance contracts.

Do you agree the Board amend IFRS 17 to:

- a. expand the scope of the exception in paragraph 66(c)(ii) of IFRS 17 to require an entity to recognize a gain in profit or loss when the entity recognizes losses on onerous underlying insurance contracts, to the extent that a reinsurance contract held covers the losses of each contract on a proportionate basis; and
- b. require an entity to apply the expanded exception when the entity measures contracts applying the PAA?

Reinsurance contracts held—onerous underlying insurance contracts

12—Measurement | Reinsurance contracts held: initial recognition when underlying insurance contracts are onerous

- **Immediate loss mitigation solution** was the possible amendments suggested by the Staff, i.e. to change the accounting for reinsurance contracts held.
- To expand the scope of the existing exception in IFRS 17 para. 66(c)(ii) requiring an entity to recognise a gain in P&L when the entity recognises losses on onerous underlying insurance contracts, to the extent that a reinsurance contract held covers the losses of each contract on a proportionate basis.
- CSM for reinsurance contracts held will be adjusted when losses are recognized on onerous underlying insurance contracts.
- The effect of this immediate loss mitigation amendment on the accounting for reinsurance contracts held entered into before or at the same time as the underlying onerous contracts are issued, is illustrated below:

Does the exception apply when:	IFRS 17	IFRS 17 with amendment
an underlying onerous group of insurance contracts is initially recognised?	No	Yes
further onerous insurance contracts are issued and join the onerous group?	In some circumstances	Yes
an underlying group of insurance contracts become onerous after initial recognition because of adverse changes in estimates of future cash flows?	Yes	Yes

Reinsurance contracts held—onerous underlying insurance contracts

12—Measurement | Reinsurance contracts held: initial recognition when underlying insurance contracts are onerous

- The Staff noted that the accounting mismatch identified by stakeholders could be resolved by requiring an entity to **recognize a gain on a reinsurance contract held when losses are recognized on the onerous underlying contracts**, to the extent that the reinsurance contract held covers the losses of each contract on a proportionate basis.
- **Scenario 1**—when a reinsurance contract held is in a net gain position and provides coverage for an underlying onerous group of insurance contracts.
- The entity issues onerous insurance contracts with a coverage period of two years and measures the loss component at initial recognition as 200. At the same time, the entity enters into a reinsurance contract that provides 50% proportionate coverage for those onerous contracts.

(Dr)/Cr	IFRS 17		IFRS 17 with amendment	
	Year 1	Year 2	Year 1	Year 2
Insurance contracts issued	(200)	0	(200)	0
Reinsurance contracts held	50	50	100	0
Insurance service result	(150)	50	(100)	0

Reinsurance contracts held—onerous underlying insurance contracts

12—Measurement | Reinsurance contracts held: initial recognition when underlying insurance contracts are onerous

- **Scenario 2**—when a reinsurance contract held is in a net cost position and provides coverage for an underlying onerous group of insurance contracts and an underlying profitable group of insurance contracts.
- The entity issues insurance contracts with a coverage period of two years. Some of the contracts are expected to be profitable and some are expected to be onerous. The entity recognises two groups of contracts: an onerous group with a loss component of 100; and a profitable group with a CSM of 200.
- At the same time, the entity enters into a reinsurance contract that provides 50% proportionate coverage for all those contracts.

(Dr)/Cr	IFRS 17		IFRS 17 with amendment	
	Year 1	Year 2	Year 1	Year 2
Profitable group of insurance contracts issued	100	100	100	100
Onerous group of insurance contracts issued	(100)	0	(100)	0
Insurance contracts issued	0	100	0	100
Reinsurance contracts held	(25)	(25)	0	(50)
Insurance service result	(25)	75	0	50

Reinsurance contracts held—onerous underlying insurance contracts

12—Measurement | Reinsurance contracts held: initial recognition when underlying insurance contracts are onerous

- This possible amendment would:
 - a. avoid significant loss of useful information
 - b. not be contrary to the general principle in IFRS that gains should not be recognised before service is provided
- The IASB Staff thought that the possible disruption to implementation arising from this amendment could be justified given stakeholder feedback about the likely significant impact of the accounting mismatch which some stakeholders suggest reduces the usefulness of the information provided by IFRS 17.
- The benefits of expanding the existing exception in IFRS 17 to resolve the accounting mismatch that is currently outside of the scope of **that exception outweigh the costs of that possible amendment**. The Staff observed that **this approach links the accounting for the reinsurance contract held to the accounting for the underlying insurance contracts**, and that the existing exception already introduces this link.

Reinsurance contracts held—onerous underlying insurance contracts

12—Measurement | Reinsurance contracts held: initial recognition when underlying insurance contracts are onerous

- The Staff observed that a similar accounting mismatch could arise when the underlying insurance contracts are measured applying the PAA, or the reinsurance contract held is measured applying the PAA, or both. Therefore, the Staff recommended that the expanded exception should apply both for contracts measured applying the general model and the PAA.
- The IASB Staff recommended the Board to amend IFRS 17 to:
 - a. expand the scope of the exception in paragraph 66(c)(ii) of IFRS 17 to require an entity **to recognize a gain in profit or loss when the entity recognizes losses on onerous underlying insurance contracts**, to the extent that a reinsurance contract held covers the losses of each contract on a proportionate basis; and
 - b. require an entity to **apply the expanded exception** when the entity measures contracts applying the PAA.
- The Board **voted unanimously** to tentatively agree with the Staff recommendation to amend the Standard.

Reinsurance contracts held—underlying insurance contracts with direct participation features 13—Measurement | Reinsurance contracts held: ineligibility for the variable fee approach

- VFA includes a choice when an entity mitigates the financial risks of VFA contracts using derivatives. The entity may choose to recognize changes in financial risk in such insurance contracts in P&L, instead of adjusting the CSM as normally required by the VFA.
- Such a choice allows entities to avoid the accounting mismatches created by VFA when an entity purchases derivatives to mitigate risks that are included in the CSM measurement.
- Modifying the scope of VFA to include reinsurance contracts held when the underlying insurance contracts issued are insurance contracts with direct participation features aiming at avoiding mismatches resulting from different patterns of CSM recognition for reinsurance contracts and underlying insurance contracts, would be inconsistent with IASB's view that a reinsurance contract held should be accounted for separately from the underlying insurance contracts issued.

Do you agree the Board amend IFRS 17 to expand the scope of the risk mitigation exception for insurance contracts with direct participation features in paragraph B115 of IFRS 17 so that it applies when an entity use a derivative or a reinsurance contract held to mitigate financial risk, to the extent that the entity meets the conditions in paragraph B116 of IFRS 17?

- The Board **voted unanimously** to tentatively agree with the Staff recommendation to amend the Standard.

Next steps

IASB

- The IASB will discuss a third batch of concerns over its meeting on **7 February 2019**. A final batch will be tabled during the IASB March meeting.
- The next TRG meeting will be held on **4 April 2019** in the IASB office in London.
- The deadline for submissions of issues and comments to TRG is **14 February 2019**, with earlier submissions encouraged to allow for earlier publication of agenda papers.

Next steps – continued

The IASB has published the IFRS 17 agenda papers for its upcoming Board meeting on 7 February 2019.

Agenda 2A Loans that transfer significant insurance risk (concern 1)

The Staff recommends the Board to:

- Amend the scope of IFRS 17 and IFRS 9 Financial Instruments for insurance contracts for which the only insurance in the contract is for the settlement of some or all of the obligation created by the contract. The amendment would enable entities issuing such contracts to account for those contracts applying either IFRS 17 or IFRS 9. Such an amendment to the scope of IFRS 9 would require consequential amendments to IFRS 7 *Financial Instruments: Disclosures* and IAS 32 *Financial Instruments: Presentation*.

Agenda 2B Transition—Optionality and comparative information (concerns 21 and 23) Optionality

The Staff recommends the Board to:

- Retain the IFRS 17 transition requirements, without amendments that would reduce optionality included in those requirements.

Comparative information

The Staff recommends the Board to:

- 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.

Next steps - continued

Agenda 2C Transition—Risk mitigation option and amounts accumulated in other comprehensive income on transition (concern 8 transitional part – non transitional part was discussed in December 2018 and January 2019 Board meetings)

The Staff recommends the Board to:

- Retain the requirements in IFRS 17 relating to the prohibition of retrospective application of the risk mitigation option on transition to IFRS 17; and
- Retain the requirements in IFRS 17 with respect to the cumulative amounts included in other comprehensive income on transition to IFRS 17.

Next steps - continued

Agenda 2D Transition—Modified retrospective approach (MRA) (concern 24)

The Staff recommends the Board to:

- 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:
 - a. Add a specified modification to the MRA to require an entity to classify such liabilities as a liability for incurred claims; and
 - b. Permit an entity applying fair value approach to choose to classify such liabilities as a liability for incurred claims
- 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 to apply the related IFRS 17 requirement retrospectively; and
 - b. Can only use a specified modification in the MRA when the entity has reasonable and supportable information to apply that modification
- Not amend IFRS 17 to permit an entity to develop its own modifications that it regards as consistent with the objective of the MRA
- Not amend the specified modification in the MRA related to the use of cash flows that are known to have occurred instead of estimating retrospectively cash flows that were expected to occur
- 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 CSM for groups of contracts with direct participation features

Contact details

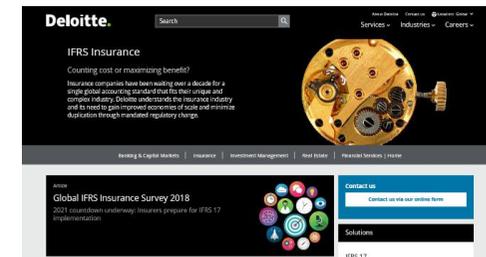
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