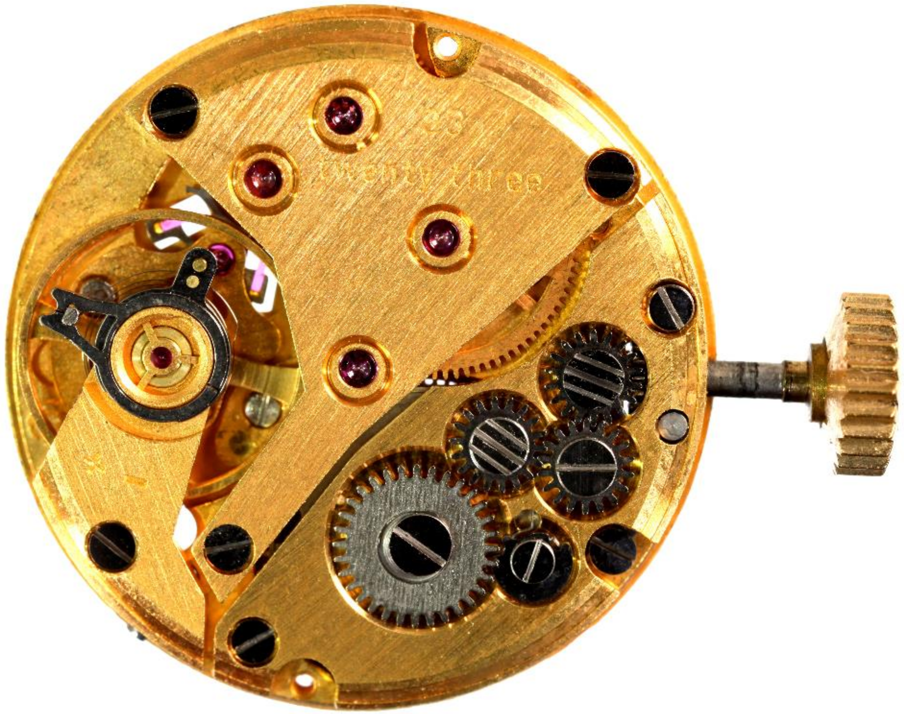


Useful sweep issues are approved with publication expected by end of June 2020

IASB approves further refinements to Amendments to IFRS 17

Francesco Nagari, Deloitte Global IFRS Insurance Leader | 2 June 2020

Agenda

- Highlights on the recent IASB meetings on 23 April 2020 and 20 May 2020
- Detailed analysis of the IASB discussion and decisions reached
- Highlights on the article published by IASB on why the annual cohort requirement of IFRS 17 was retained unchanged
- Next steps

Highlights on the recent IASB discussions and decisions

- On 23 April 2020, the IASB Staff provided the Board with an oral update on the progress of the balloting process of the Amendments to IFRS 17 and on other activities to support the implementation of IFRS 17.

- On 20 May 2020, the IASB discussed and **approved unanimously nearly all** of the sweep issues:

  - Accounting for **pre-recognition cash flows** other than insurance acquisition cash flows (IACF);
  - Treatment of **assets and liabilities for cash flows** related to a group of insurance contracts recognised before the group is recognised;
  - **Inclusion** as part of insurance revenue for amounts related to **income tax specifically chargeable** to policyholders;
  - **Refined** the key definitions of liability for remaining coverage and liability for incurred claims;
  - Clarified how to apply together the **OCI option** and the **risk mitigation option** for contracts accounted for under the variable fee approach;
  - Amendment to paragraph B96(c) to **clarify** the treatment of the effects of **investment components** unexpectedly paid or unexpectedly not paid making the CSM accounting simpler

- The Board voted with a **majority of 12 in favour against 2** on the amendment relating to the use of a systematic and rational allocation method when determining the amount of recovery of losses from reinsurance contracts held.

Oral update by the IASB Staff during the April 2020 IASB meeting

- Key highlights from the oral update by the IASB Staff

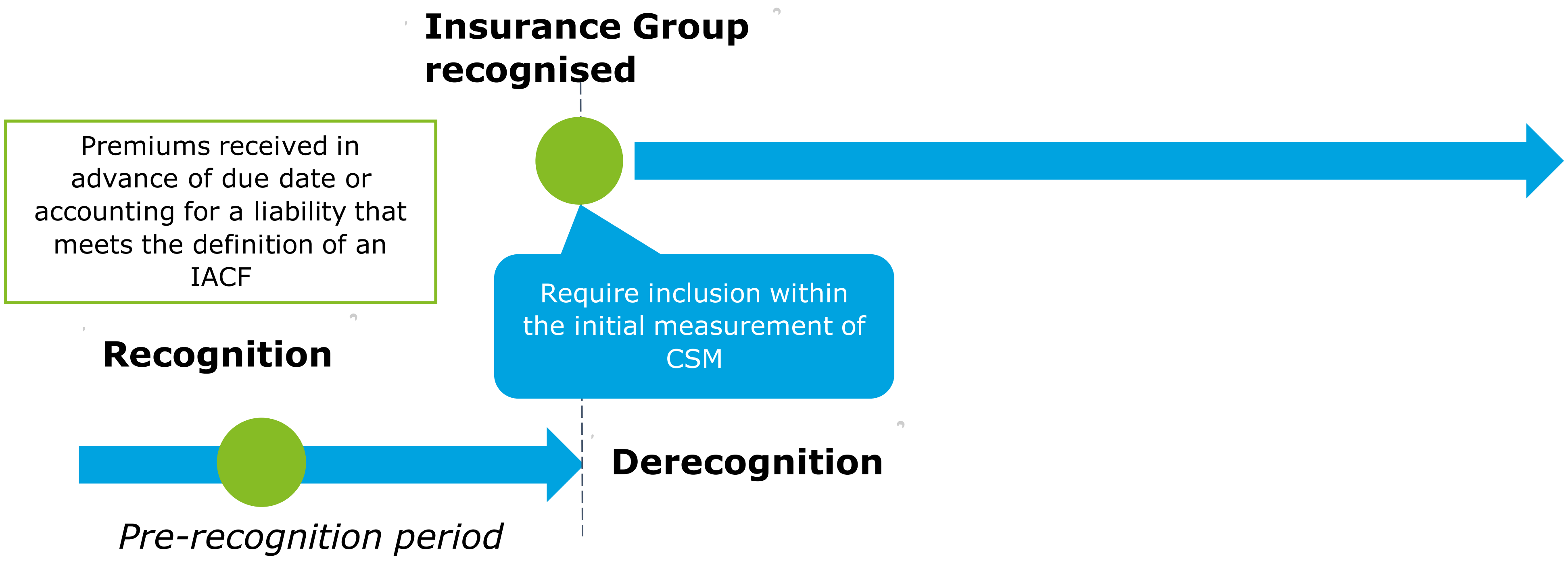
  - **Finalisation** of the Amendments to IFRS 17 (“amendments”) is confirmed as urgent to avoid undue disruption to ongoing implementation projects.
  - Amendments to IFRS 17 expected to be published by the **end of June 2020**.
  - Existing educational materials on IFRS 17 will be retained without updating it for the amendments. A **webcast on changes brought by the amendments** will be released after the publication of the amendments.
  - The **IFRS 17 Transition Resource Group has not been disbanded** and continues to be **available for consultation** but **no further meetings are scheduled at present.**
  - Stakeholders are welcome to **raise** any implementation issues to the IASB Staff using the available channel provided in the IASB website, including the TRG mailbox.

Sweep issues

Accounting for pre-recognition assets, liabilities and cash flows other than IACF

- **Sweep issue**: The Staff noted there could be other cash flows related to a group of insurance contracts that are paid or received before the group is recognised. Current wording of IFRS 17 does not allow for their inclusion in the calculation of the contractual service margin ("CSM") at initial recognition.

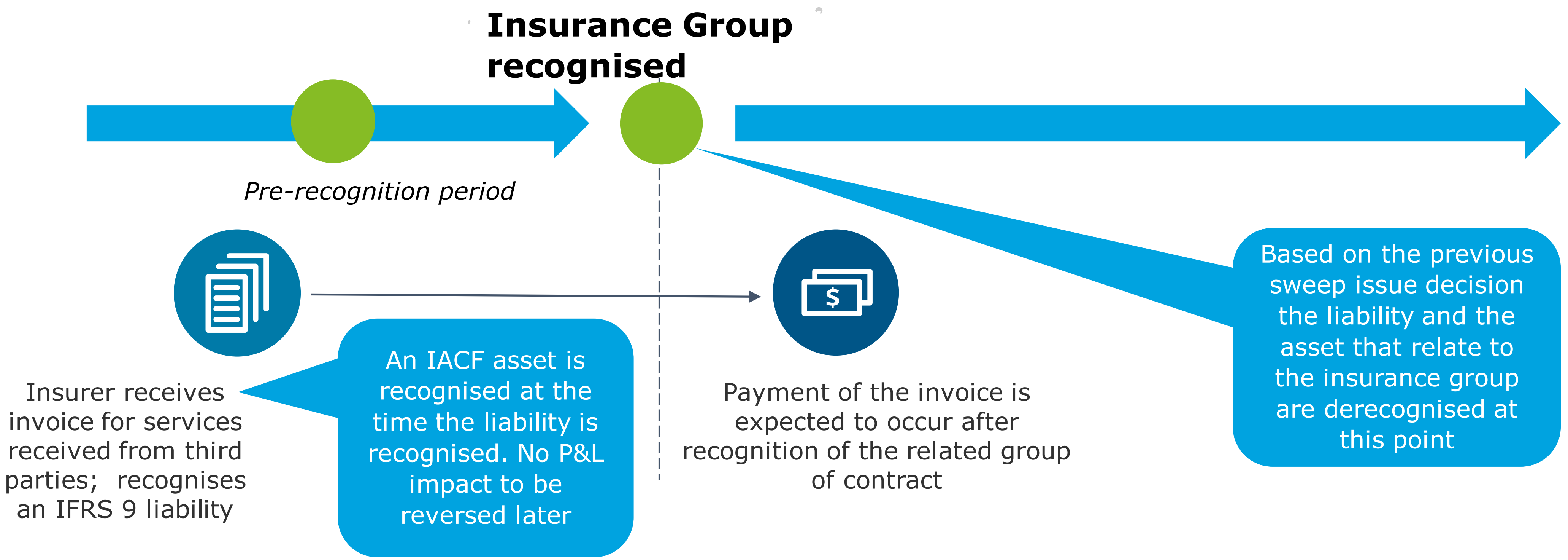
- The Board approved to **amend** IFRS 17 to require an entity to **include in the initial measurement of the CSM** of a group of insurance contracts the effect of the **derecognition of any asset or liability** previously recognised for cash flows related to that group and accounted for before the group is recognised.



Sweep issues

Treatment of assets and liabilities for cash flows related to a group of contracts recognised before the group is recognised

- **Sweep issue:** The Staff noted that there could be a situation where an insurer has been invoiced for services received from third parties and would recognise a liability under IFRS 9, *Financial Instruments,* for the unpaid invoice. The cash flows, when the liability is settled, will meet the definition of an IACF.
- The Board approved to **amend** IFRS 17 to require an entity to **recognise an asset** for insurance acquisition cash flows to include **future cash flows for which a liability has been recognised** applying another IFRS and before the related group of contracts is recognised.



Sweep issues

Inclusion in insurance revenue of amounts related to income tax specifically chargeable to policyholders

- **Sweep issue:** The intended consequence of the amendment on IFRS 17:B65(m) is for an entity to recognise insurance revenue for the consideration paid by the policyholder for those income tax amounts in a manner consistent with the recognition of insurance revenue for other incurred expenses applying IFRS 17.

- The Board approved to **amend** IFRS 17 to require an entity to **recognise insurance revenue** when the entity recognises in profit or loss amounts related to income tax that are **specifically chargeable to the policyholder** under the terms of an insurance contract.

Analysis of insurance revenue*

Amounts related to liabilities for remaining coverage	**X**
Expected claims and other insurance service expenses	X
Amounts related to income tax that are specifically chargeable to policyholders	**X**
Risk adjustment for non-financial risk for the period	X
Release of CSM	X
Experience adjustments for premium receipts	
Amounts related to recovery of insurance acquisition cash flows	**X**
Total insurance revenue	**X**

Inclusion as part of insurance revenue. Separate line item in the Analysis of insurance revenue

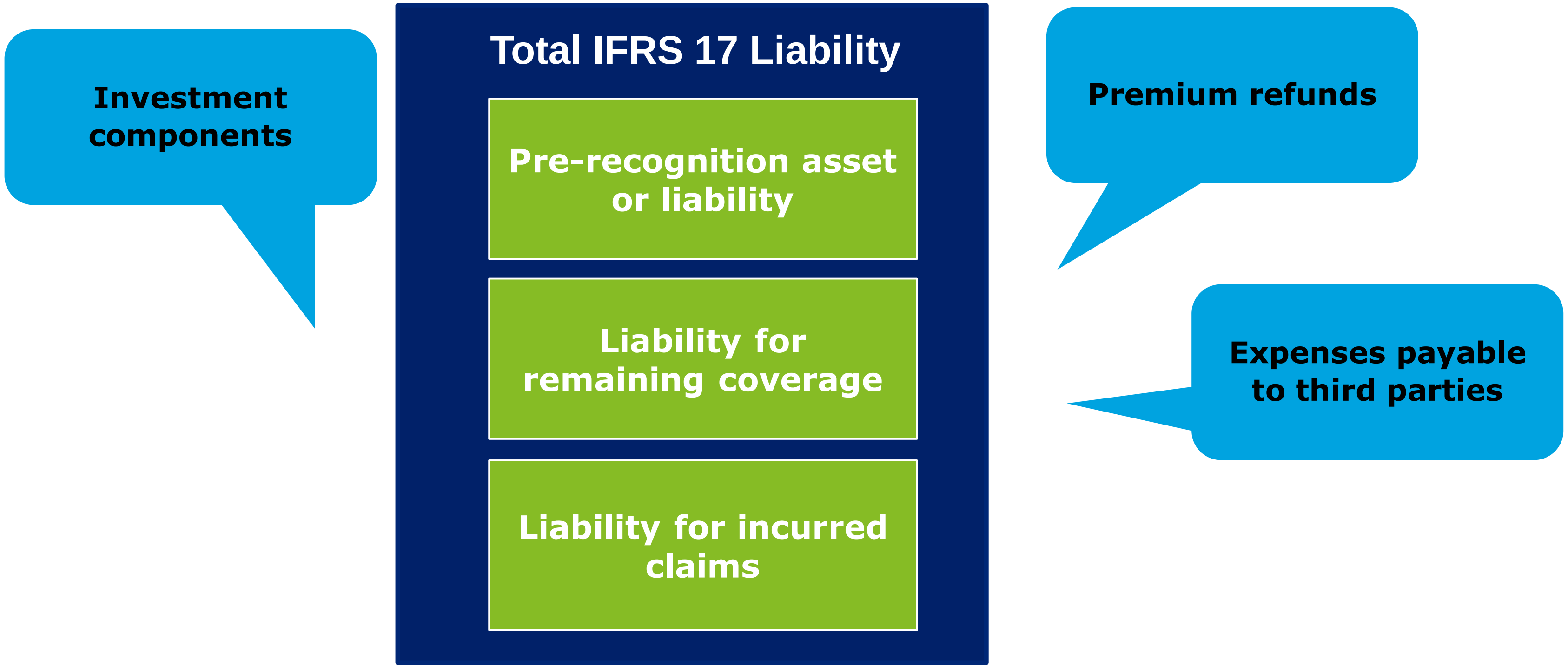
*For illustration purposes only.

Sweep issues

Improved definitions of the liability for remaining coverage and liability for incurred claims

- **Sweep issue:** Some respondents commented that the proposed revised definitions for liability for remaining coverage ("LRC") and liability for incurred claims ("LIC") reflect some, but not all, of an entity's obligations arising from insurance contracts.

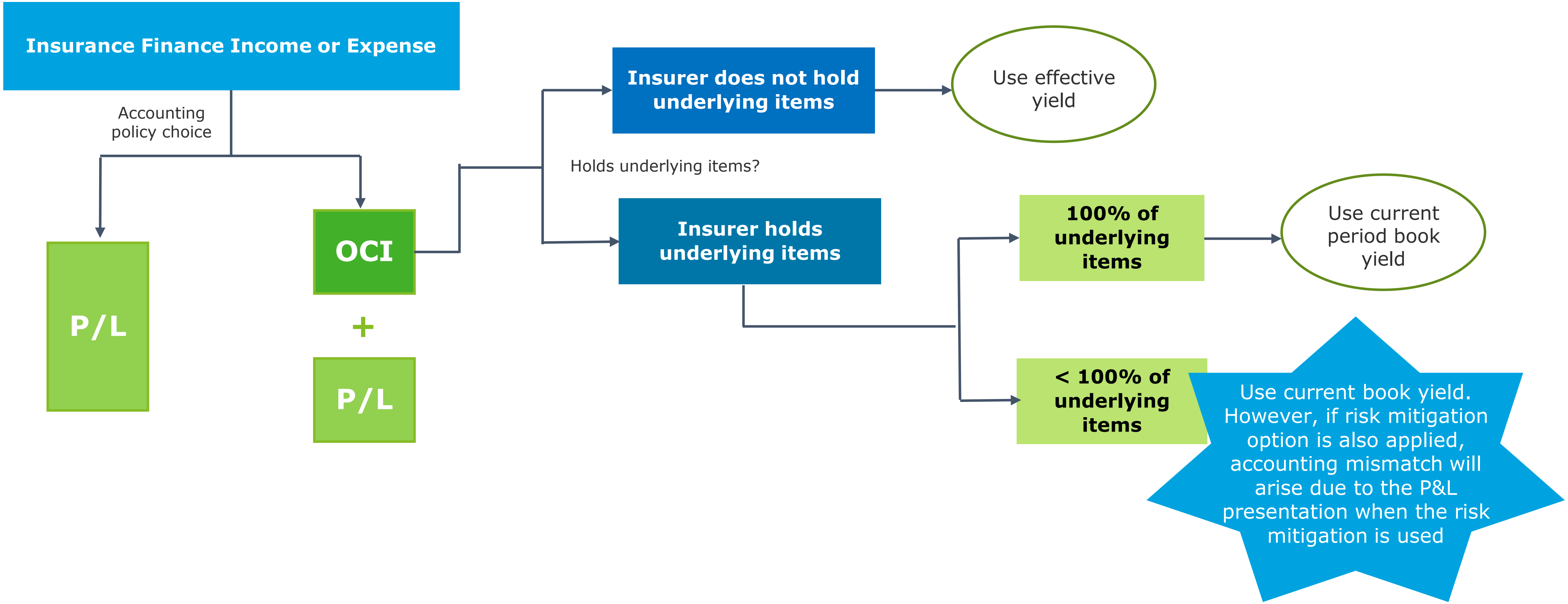
- The Board approved to **amend** IFRS 17 to include in the definitions of the LRC and the LIC **all obligations** arising from insurance contracts issued by an entity. Both definitions have a more precise "catch all" structure that should work in all cases.



Sweep issues

Applying together the OCI option and the risk mitigation option for contracts applying variable fee approach

- **Sweep issue:** The Staff noted that an entity applying the OCI option under IFRS 17:89(b) (the current period book yield method) might also elect to apply the risk mitigation option in IFRS 17. If so, an **accounting mismatch** will arise.



Sweep issues

Applying together the OCI option and the risk mitigation option for contracts applying variable fee approach

- The Board approved to **amend** the **OCI option** and the **risk mitigation option** in IFRS 17 to:

  (a) specify that IFRS 17:88 and 89 do not apply to the IFIE that arise from the application of the risk mitigation option; and

  (b) add **new requirements** to the risk mitigation option specifying how to present IFIE that arise from the application of the risk mitigation option. Such requirement will require an entity to present changes in the insurance contract liability as follows:

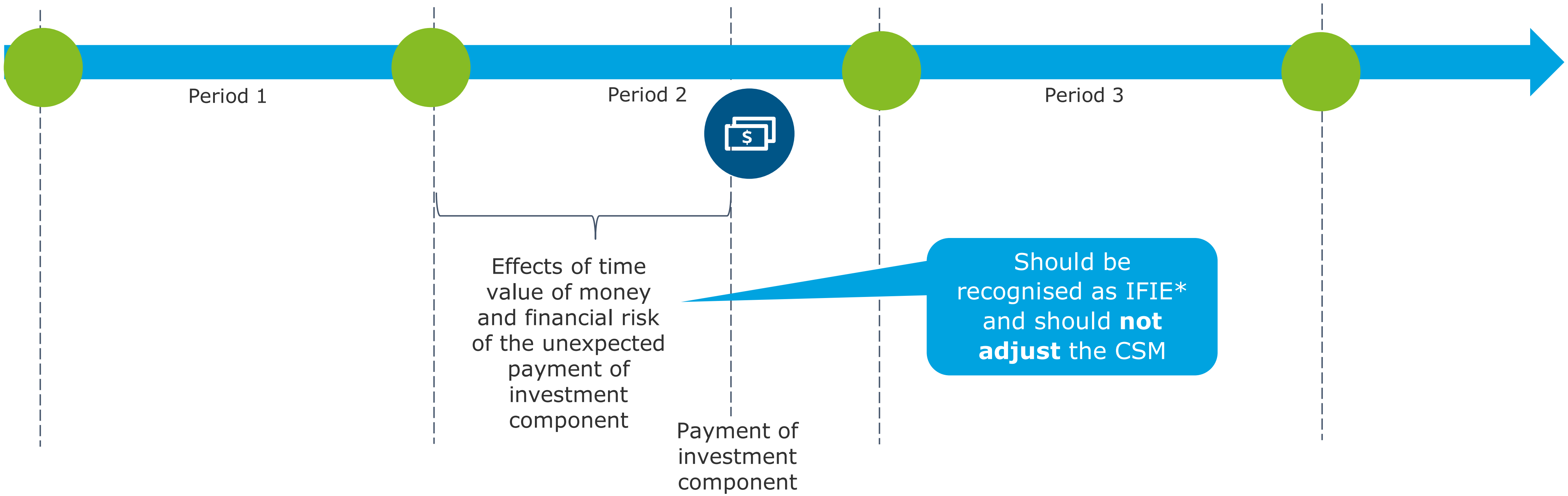
Hedging instrument	Presentation of the changes in the insurance liability
Financial assets measured at fair value through profit or loss and derivatives	Profit or loss
Reinsurance contracts held	The same OCI accounting policy the entity has chosen for the mitigating reinsurance contracts held (i.e. IFRS 17:88 and 90)

Sweep issues

Treatment of effects of investment components that were unexpectedly paid or unexpectedly unpaid

- **Sweep issue: Paragraph B96(c) of IFRS 17, as currently worded,** may results in varying interpretations.

- The Board approved to amend paragraph B96(c) to **clarify** the treatment of the effects of investment components unexpectedly paid or unexpectedly not paid. The illustration below shows a scenario where investment component is unexpectedly paid.



*IFIE – Insurance finance income or expense

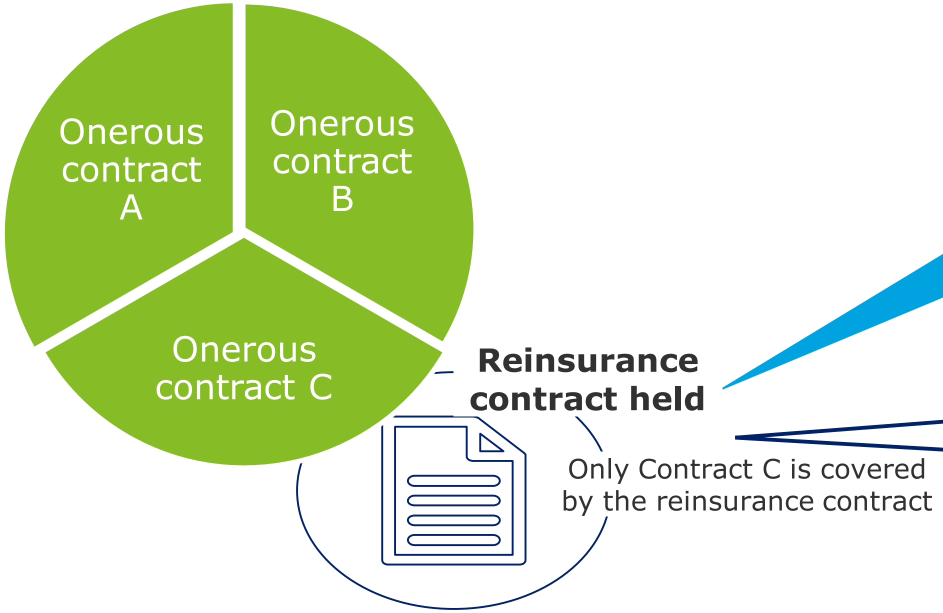
Sweep issues

Use of a systematic and rational allocation method when determining the amount of recovery of losses from reinsurance contracts held

- **Sweep issue:** The Staff noted an entity may group together onerous contracts covered by a particular reinsurance contract with other onerous contracts not covered by that reinsurance contract and the entity might not have information on a more granular basis to be able to determine the amount of losses on underlying insurance contracts for purpose of determining the amount of recovery of losses from reinsurance contracts held.

- The Board approved (12 vs. 2) to **amend** IFRS 17 to require the use of a **systematic and rational allocation method**[1] when determining the amount of recovery of losses from reinsurance contracts held in the specific circumstance described above.

A group of onerous contracts



Determining the amount of recovery of losses from reinsurance contracts held

- At initial recognition, use a systematic and rational allocation method to determine the portion of losses of the onerous group that relates to the underlying insurance contracts*

- Use a systematic and rational allocation method to determine the **portion of subsequent changes** in the loss component of the group that relates to the underlying insurance contracts*

1 Final text verbally agreed at the IASB meeting when this sweep issue was approved.

2 Underlying insurance contracts – contracts that are covered by the reinsurance contract

Why annual cohorts?

Reasons supporting IASB decisions to retain unchanged the annual cohort requirement

- On 28 April 2020, the IASB published an article written by its Chair, Hans Hoogervorst, on the reasons behind the IASB's decision to retain unchanged the annual cohort requirements in IFRS 17. The article deals with the following topics:

  - Application of most financial reporting requirements at the **individual contract level**;
  - Why accounting for individual insurance contracts is not appropriate;
  - Annual cohorts approach being **essential for prudent planning**;
  - Objections by stakeholders to the annual cohort requirement raised during the recent consultation (discussed in subsequent slides);
  - The IASB's deliberations on the annual cohort requirement.

Why annual cohorts?

Reasons supporting IASB decisions to retain unchanged the annual cohort requirement

- The annual cohort requirement has been a subject of **much debate** since the publication of IFRS 17 in May 2017. Main rationale for the annual cohort requirement:

Essential for prudent planning

Annual cohort requirement

Provide information about changes in profitability of insurance contracts over time

Timely recognition of losses

Why annual cohorts?

Reasons supporting IASB decisions to retain unchanged the annual cohort requirement

- The article aims to respond on the three key concerns raised by various stakeholders on the annual cohort requirement, in particular, as it applies to contracts with intergenerational sharing of risks.

Do annual cohorts fail to reflect intergenerational sharing of risks?

- Extent of mutualisation **varies widely** across different contracts.
- Contracts that share all types of risks fully across policyholders with the insurer bearing no risk are very uncommon.
- Significant differences in financial performance can occur between different annual cohorts, particularly when contracts include minimum guarantees.
- The effect of the minimum guarantee on the insurer's share could cause an individual annual cohort to become **onerous**, especially in an **ultra-low or negative interest environment**.
- If CSM is not accounted by annual cohort, it may result in:
  - losses not recognised on a timely basis;
  - financial statements not representing meaningful trends in profitability.

Why annual cohorts? (cont.)

Reasons supporting IASB decisions to retain unchanged the annual cohort requirement

- The article aims to respond on the three key concerns raised by various stakeholders on the annual cohort requirement, in particular, as it applies to contracts with intergenerational sharing of risks.

Do annual cohorts result in arbitrary allocations?

- Subsidisation is a fundamental principle for contracts with intergenerational sharing of risk. Accordingly, IFRS 17 requires the effect of that subsidisation to be included in the measurement of the annual cohorts.
- The **adjustments** to allow for changes in the fulfilment cash flows and the CSM of each annual cohort, depict the extent to which profit from existing contracts are expected to subsidise future/other contracts or vice versa.
- The annual cohort requirement provides useful insights about how management expects the business to develop.

Why annual cohorts? (cont.)

Reasons supporting IASB decisions to retain unchanged the annual cohort requirement

- The article aims to respond on the three key concerns raised by various stakeholders on the annual cohort requirement, in particular, as it applies to contracts with intergenerational sharing of risks.

Are annual cohorts too costly for contracts with intergenerational sharing of risks?

- Although the use of annual cohorts adds complexity to accounting systems, the requirement remains appropriate as **the costs of the requirement are outweighed by the benefits of the resulting information**.
- Any exemption would add **further complexity** to IFRS 17, and may result in an unacceptable loss of useful information.
- In practice, annual cohorts may not always be necessary. The requirements in IFRS 17 specify the amounts to be reported, not the methodology to be used to arrive at those amounts.

Next steps

- The Staff announced that they expect the publication of the amended IFRS 17 by end of June 2020.
- Deloitte will publish a recorded insurance webcast once the *Amendments to IFRS 17* are published to recap on the amendments after the ballot process has completed the fine tuning of the text previously exposed for comment.

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