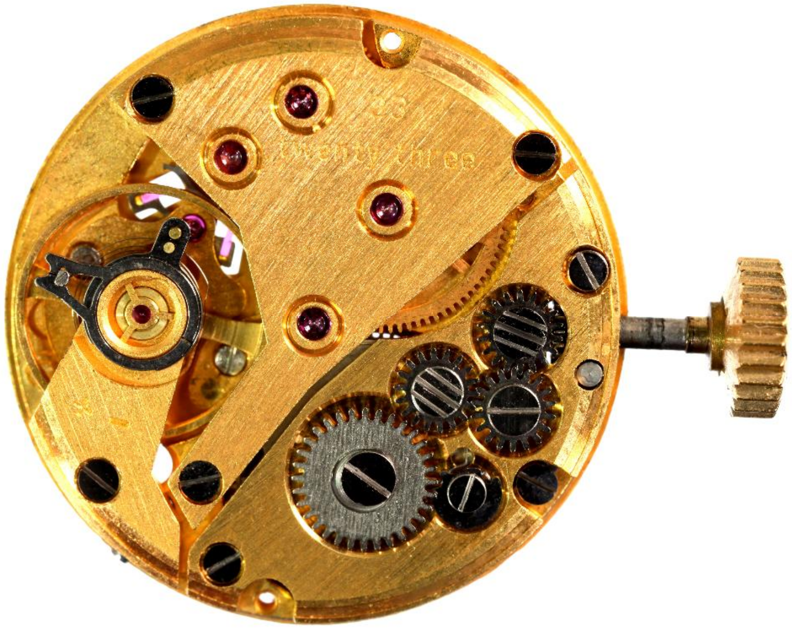

Overview of Exposure Draft *Amendments to IFRS 17*

A joint briefing from the IASB and Deloitte

Francesco Nagari, Deloitte Global IFRS Insurance Leader | 8 July 2019

Our speakers today

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The views expressed in this presentation are those of the presenter, not necessarily those of the International Accounting Standards Board or IFRS Foundation.

Objectives of the proposed amendments

Maintain IFRS 17 improvements

- The targeted amendments
  - do not change the fundamental principles of the Standard
  - will not result in a significant loss of useful information for investors
  - refine the requirements for some topics, in the light of insurers' experience when starting implementation

Aid implementation

- The targeted amendments
  - are narrow in scope but provide meaningful support and address a number of concerns raised by insurers
  - will ease IFRS 17 implementation, without unduly disrupting implementation
  - will make it easier for insurers to explain the results of applying IFRS 17 to investors

Not all possible amendments meet the criteria

Amendment not justified **or** Significant loss of information **or** Unduly disrupt implementation

Reinsurance contract boundary	Excluding cash flows of reinsurance contracts held relating to underlying contracts not yet issued would go against the fundamental principle in IFRS 17 that all future cash flows are reflected in the measurement of an insurance contract
Level of aggregation	Suggested amendments could result in: • loss of information about trends in the entity's profitability • delayed recognition of losses on onerous contracts / profit on profitable contracts
Reducing OCI optionality	Requiring, rather than permitting, insurance finance income or expenses to be presented either entirely in profit or loss or partly in other comprehensive income (OCI) to improve comparability could require significant rework for preparers

What are the practical implications?

Reinsurance contract boundary	• The **contract boundary** concept is one of the cardinal principles in IFRS 17 and it has already called for substantial implementation efforts. • The estimation of future business ceded under a reinsurance contracts and within its boundary require more sophisticated **assumptions management** and the accounting of the **discount rate differential** between the **unlocking** of reinsurance CSM and the **update of the fulfilment cash flows** from future business ceded.
Level of aggregation	• The level of aggregation is as important and impactful as the contract boundary from a practical implementation perspective. • The **CSM measurement** through the unlocking process and its allocation to insurance revenue will remain based on the group of contracts, bound by the annual time limit and the requirement to separate the three profitability conditions.
Reducing OCI optionality	• The optionality sought after by preparers but criticized by several investors will be implemented with the required IFRS 17 presentation and disclosure details that should allow investors to fully appreciate the impact of an OCI choice across the market

12 targeted amendments in 8 areas

1 Deferral of the effective date by one year

- IFRS 17
- IFRS 9

2 Additional scope exclusions

- Loans
- Credit cards

3 Allocation of acquisition costs to expected contract renewals

4 Attribution of profit to service relating to investment activities

5 Extension of the risk mitigation option

6 Reduced accounting mismatches for reinsurance

7 Simplified balance sheet presentation

8 Additional transition reliefs

- Business combinations
- Risk mitigation from the transition date
- Risk mitigation and fair value approach

1 Deferral of the effective date by one year

Concerns and challenges raised

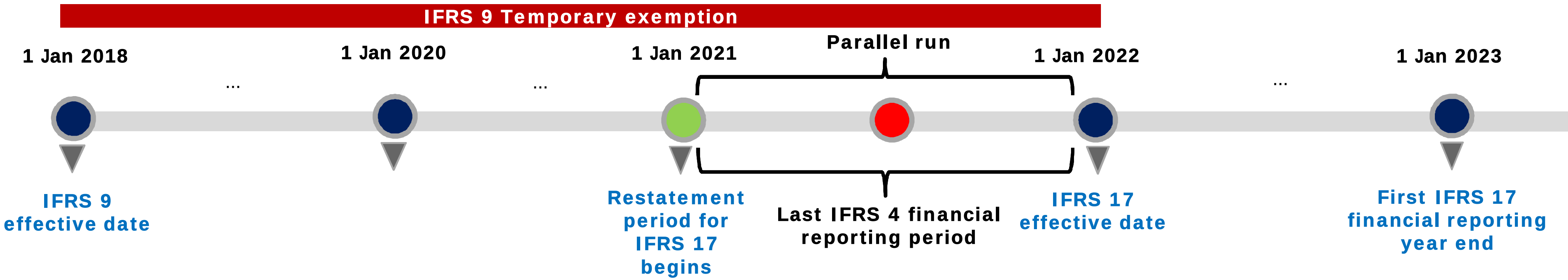
- Limitations in the availability of internal or third party experts, particularly actuaries and IT systems providers
- Entities need more time to prepare than they originally expected
- Uncertainty arising from the discussion about possible amendments to IFRS 17 and subsequent changes affects planning and budget of entities implementing IFRS 17

IASB's response

- One-year deferral of the effective date of IFRS 17 (based on uncertainty created by possible amendments)
- Extension to 2022 of the expiry date for the temporary exemption from applying IFRS 9 (for some insurers)
- Need to have timely application of IFRS 17 and IFRS 9

Proposed amendment

What are the practical implications?



- **This provides relief for insurance companies who are not in line for completion by 1/1/2021.**

- **Insurers in an advanced stage of implementation work have not reduced their pace and have instead used the extra time to deliver higher quality implementation outputs, particularly around data.**

- **Software vendors can use this additional time to complete or refine the development of their IFRS 17 solutions. Particularly those that fall in the category of finance-actuarial sub-ledgers, a much sought after software to manage the calculation and posting of CSM.**

- **However, new specifications would need to be included in their solutions following the finalisation of the ED.**

2 Scope exclusion for some loans

Concerns and challenges raised

- A loan contract that transfers significant insurance risk is an insurance contract that contains both a loan and an insurance component
- Applying IFRS 4 some entities separate the loans in such contracts and apply IFRS 9 to those loans
- IFRS 17 does not permit the continuation of this practice
- IFRS 17 currently applies to the loan contract in its entirety

IASB's response

- Permitted to apply either IFRS 17 or IFRS 9 to insurance contracts that provide insurance coverage only for the settlement of the policyholder's obligation created by the contract
- The choice would be made portfolio by portfolio, using the IFRS 17 definition of a portfolio

Proposed amendment

IFRS

2 Scope exclusion for some credit cards

Concerns and challenges raised

- Some credit card contracts provide insurance coverage—for purchases made using the credit card—free or for a fixed fee
- Entities that today account for those credit card contracts applying IFRS 9 would need to change the accounting when IFRS 17 is effective, shortly after having incurred costs to comply with IFRS 9

IASB's response

- IFRS 17 would not apply to credit card contracts for which the fee charged to the customer does not reflect an assessment of the insurance risk associated with that individual customer
- Other relevant IFRS Standards apply (eg IFRS 9, IFRS 15 or IAS 37)

Proposed amendment

What are the practical implications?

- A neutral change for insurance companies but a lower cost for banks and other financial institutions that sell these contracts.

- Contracts accounted under IFRS 9 will be measured at FVTPL if they do not meet SPPI criteria.

3 Allocation of acquisition costs to expected contract renewals

Concerns and challenges raised

- Commissions paid unconditionally on contracts that have been issued cannot be allocated to expected contract renewals
- In some cases, commissions may exceed the premium for the initially written contracts causing the contracts to be onerous – viewed as being inconsistent with economics

IASB's response

- Part of insurance acquisition cash flows would be allocated to expected contract renewals
- Cash flows recognised as an asset until the entity recognises contract renewals
- Recoverability of the asset assessed each period

Proposed amendment

3 Allocation of acquisition costs to expected contract renewals—Example

- Non-refundable commissions paid for new contracts expected to be renewed
- Sometimes the commission exceeds premiums for the initial contract because the insurer expects the commission will be recovered from renewals

IFRS 17 (as originally issued)

Cash flows	Year 1 (initial contract)	Year 2 (expected renewal)	Year 3 (expected renewal)
Premium	**100**	**100**	**100**
Claim	**-**	**-**	**-**
Commission	**(150)**	**-**	**-**
Expected (loss) / unearned profit	**(50)**	**100**	**100**

Proposed amendment

Cash flows	Year 1 (initial contract)	Year 2 (expected renewal)	Year 3 (expected renewal)
Premium	**100**	**100**	**100**
Claim	**-**	**-**	**-**
Commission	**(50)**	**(50)**	**(50)**
Expected unearned profit	**50**	**50**	**50**
Asset for acquisition costs	**(100)**		

What are the practical implications?

- The continuing recognition of insurance acquisition cash flows allocated to expected contract renewals as an asset is expected to reduce the number of insurance contracts that are determined to be onerous at initial recognition when prepaid renewal commissions are awarded on the first contract sold to a new policyholder.

- Accounting of pre-coverage cash flows is improved.

- IFRS 17 now explains the allocation basis from the pre-coverage to the correct group of contracts, the need for impairment and the need for disclosures in terms of respected duration for the full balance at the reporting date to be allocated to future groups.

- Insurers with material pre-coverage assets are expected to incur additional costs to implement the process that will ensure the proper accounting for pre-coverage assets. This is expected to have significant implication around the solution design for data and systems.

4 Attribution of profit to service relating to investment activities

Concerns and challenges raised

- For insurance contracts without direct participation features, contractual service margin recognised in profit or loss considering only insurance coverage
- For some contracts the insurance coverage period differs from the period in which the policyholder gets return on an investment component

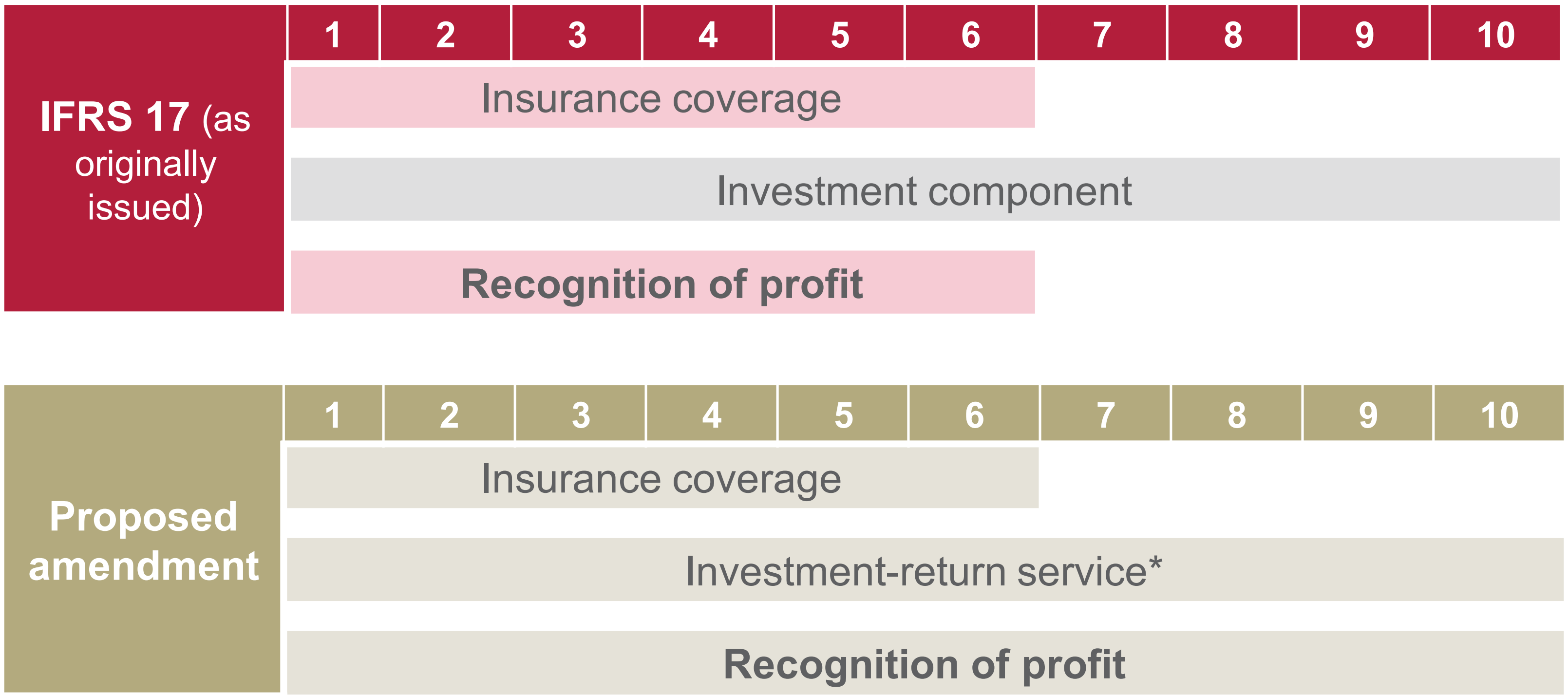
IASB's response

- For insurance contracts without direct participation features, recognise the contractual service margin in profit or loss considering both insurance coverage and any investment-return service

Proposed amendment

4 Attribution of profit to service relating to investment activities—Example

- 10-year contract with an investment component providing insurance coverage for the first 6 years



* Not all insurance contracts with an investment component provide investment-return service

What are the practical implications?

- This is expected to **clarify the solution design** around coverage units and the CSM calculation requirements.

- Practical implications would call for preparers to focus their project work on the blended approach required and the need to refine data feeds to CSM calculation and posting systems.

5 Extension of the risk mitigation option

Concerns and challenges raised

- Derivatives or reinsurance contracts may be used to mitigate financial risks arising from insurance contracts with direct participation features
- When derivatives mitigate financial risks, the entity can choose to recognise changes in insurance contracts in profit or loss, rather than as adjustments to the contractual service margin, to offset the changes in fair value of derivatives (risk mitigation option)

IASB's response

- For insurance contracts with direct participation features, permitted to use the risk mitigation option also when the entity uses reinsurance contracts held to mitigate financial risks

Proposed amendment

What are the practical implications?

- **The extension of the risk mitigation option is expected to reduce accounting mismatches and therefore the complexity for users of financial statements in understanding the accounting.**

6 Reduced accounting mismatches for reinsurance

Concerns and challenges raised

- On initial recognition of onerous insurance contracts losses recognised immediately
- When those losses are covered by a reinsurance contract held any corresponding gains are recognised over the coverage period
- Accounting mismatches may arise

IASB's response

- An entity that recognises losses on onerous insurance contracts at initial recognition would also recognise a gain on reinsurance contracts held, to the extent that the reinsurance contracts (i) cover the losses of the underlying contracts on a proportionate basis and (ii) are entered into before the onerous underlying contracts are issued

Proposed amendment

6 Reduced accounting mismatches for reinsurance—Example

IFRS 17 (as originally issued)

Insurance contracts issued	
Premiums	100
Claims	(150)
Expected loss (recognised immediately)	(50)
Proportionate reinsurance contracts held	
Reinsurance premiums	(125)
Claims recovered from reinsurance (80%)	120
Net cost (recognised over time)	(5)

Proposed amendment

Insurance contracts issued	
Premiums	100
Claims	(150)
Expected loss (recognised immediately)	(50)
Proportionate reinsurance contracts held	
Reinsurance premiums	(125)
Claims recovered from reinsurance	120
of which:	
- recovery of loss	40
- remaining claims	80
Net cost	(5)
of which:	
- gain recognised immediately (*)	40
- adjusted net cost recognised over time	(45)

(*) Gain on reinsurance contracts held of 40 is equal to the expected loss of the underlying insurance contracts multiplied by the fixed percentage of claims the insurer has a right to recover from the reinsurer (50 x 80% = 40)

IFRS

What are the practical implications?

- The actuarial model for reinsurance contracts held should be able to cope with the new requirements and deliver the significant reduction of the accounting mismatch that may have emerged from the original text.

- The classification of different types of reinsurance contracts across the proportional and non-proportional coverage will present the key practical challenge.

- A number of stakeholders are anticipated to recommend removing the qualification on proportional coverage for reinsurance credits to be recognized on reinsured groups that are initially onerous.

7 Simplified balance sheet presentation

Concerns and challenges raised

- Groups of insurance contracts presented in an asset position separately from groups of insurance contracts in a liability position
- To do this, need to identify premiums received and premiums receivable for each group of insurance contracts
- Better IT systems integration is needed resulting in significant implementation costs

IASB's response

- Insurance contract assets and insurance contract liabilities presented in the balance sheet using portfolios of insurance contracts rather than groups of insurance contracts

Proposed amendment

What are the practical implications?

- This removes the only visible requirement to present groups of insurance contracts in the primary financial statements (unless a group is onerous).

- The implementation of the necessary upgrades on working capital systems (e.g. premium collection and claims disbursement systems) are expected to be less complex with a higher level of aggregation required for balance sheet presentation.

8 Transition—use of estimates

Concerns and challenges raised

- Stakeholders raised concerns that the specified transition reliefs in IFRS 17 implied that entities could not make estimates in determining transition amounts

IASB's response

- The Basis for Conclusions on the Exposure Draft of proposed amendments to IFRS 17 explains that IASB expects entities to make estimates in determining transition amounts

8 Transition—business combinations

Concerns and challenges raised

- Liabilities for claims settlement are treated as a 'liability for remaining coverage' if the contracts were acquired in a business combination and as a 'liability for incurred claims' if the contracts were issued by the entity
- Some entities use a single system to manage all liabilities for claims settlement and find it difficult to obtain the required data to separate and measure liabilities for claims settlement in two different ways

IASB's response

- At transition account for liabilities for claims settlement acquired in a business combination as a 'liability for incurred claims' if the entity does not have reasonable and supportable information to apply a retrospective approach

What are the practical implications?

Transition - Business Combinations

- For insurers with a dominant PAA implementation project this simplification offers some cost saving.
- However the need to implement a CSM system for acquired liability for incurred claims remains in place for the full restatement period and for future business combinations and portfolio transfers.
- The difference between fair value and fulfilment cash flows is expected to go in the opening retained earnings balance.

8 Risk mitigation from the transition date

Concerns and challenges raised

- The risk mitigation option cannot be applied for periods before the date of initial application of IFRS 17—ie before the beginning of the annual reporting period in which IFRS 17 is first applied
- This prohibition may affect comparative information for the period immediately before the date of initial application

IASB's response

- An entity would be permitted to apply the risk mitigation option from the date of transition to IFRS 17—ie the beginning of the annual reporting period immediately before the date of initial application—if the entity designates the risk mitigation relationships to which it will apply the risk mitigation option no later than that date

8 Risk mitigation and fair value approach

Concerns and challenges raised

- The risk mitigation option cannot be applied retrospectively
- If risk mitigation activities were in place before the date of initial application of IFRS 17 some stakeholders think that equity on transition and revenue recognised in future periods might be distorted

IASB's response

- An entity would be permitted to use the fair value approach to transition, if it chooses to apply the risk mitigation option prospectively from the transition date, has used derivatives or reinsurance to mitigate financial risk before the date of transition and can apply IFRS 17 retrospectively

What are the practical implications?

Risk mitigation option and fair value transition approach

- This is an innovative way of resolving the issue of accounting mismatch that is likely to persist for a number of years after transition.

- Fair value complexity would be the trade-off in terms of the practical implications with the need to fair value both legs of the hedging relationship. This may include both derivatives and reinsurance contracts held as the designated hedging instruments.

Next steps

Proposed amendments set out in Exposure Draft

90 day comment period (26 June 2019 – 25 September 2019)

Outreach to obtain additional feedback

Comments welcomed from all stakeholders

IASB will finalise amendments to IFRS 17 considering the feedback on the Exposure Draft

IASB materials published in June 2019

Exposure Draft *Amendments to IFRS 17*—specifies the proposed amendments to IFRS 17 for the accounting for insurance contracts

Basis for Conclusions on the Exposure Draft—summarises IASB's considerations in developing the proposed amendments

Snapshot of Amendments to IFRS 17—provides an overview of the proposed amendments to IFRS 17

Version of IFRS 17 incorporating the proposed amendments

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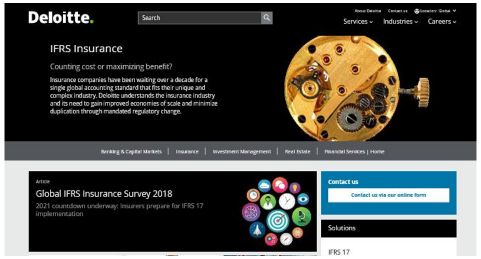

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