Acquiring insurance contracts

Transfers of insurance contracts and business combinations under IFRS 17 and IFRS 3

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Transfers of insurance contracts and business combinations

What's the issue?

Insurance contracts acquired will be subject to new requirements under IFRS 17 *Insurance Contracts*, whether via a transfer of insurance contracts or via a business combination in the scope of IFRS 3 *Business Combinations*.

Insurance contracts acquired will be classified and measured based on their contractual terms, economic conditions and other factors as at the date of acquisition, not their date of inception (or modification).

There are specific reliefs and exceptions that may apply depending on when insurance contracts are acquired – i.e. before transition, in the comparative period or after initial application of IFRS 17.

What's the impact?

For some insurance contracts, classification and measurement will differ significantly between those that are issued and those that are acquired.

These measurement differences may cause a 'dual CSM' for parent and subsidiary reporting, which will need to be tracked and explained.

When and how a contract is acquired will also impact the accounting for those contracts.

Previously recognised intangible assets (under IAS 38 *Intangible Assets)* related to insurance contracts acquired may also need to be adjusted.

What's next?

- Identify your past acquisitions and information you have available.
- Assess your systems and processes to ensure they can support the new accounting requirements.
- Educate stakeholders on the financial impacts of the new requirements when preparing for future transfers of insurance contracts or business combinations.
- Involve specialists: transfers of insurance contracts or business combinations are often unique and complex.

Issues to consider

on applying IFRS 17 and IFRS 3 to past and future transfers of insurance contracts and business combinations

01 Insurance contracts acquired

In practice, companies may acquire rather than issue an insurance contract – i.e. they might acquire the contractual rights and obligations of previously issued insurance contracts from another company.

Under IFRS 17, **insurance contracts acquired will need to be classified** based on the contractual terms, economic conditions and other factors as **at the date of acquisition**.

At the date of acquisition, a company will need to apply all of IFRS 17's requirements, including:

- assessing significant insurance risk;
- determining the measurement model – i.e. premium allocation approach (PAA), general measurement model (GMM) or variable fee approach (VFA); and
- measuring the contractual service margin (CSM) or loss component (if applicable).

Insurance contracts issued are assessed at inception (or modification).

Therefore, **insurance contracts acquired with identical contractual terms and conditions at inception to insurance contracts issued may be accounted for differently**.

Acquired contracts may not be permitted to be grouped together with issued contracts because they may have significantly different risks as at the date of acquisition.

02 Classification and measurement

For some types of insurance contracts acquired, the **classification and measurement differences will be significant.**

For example, **Contract A** and **Contract B** have identical contractual terms and conditions at inception. **Contract B** is assessed at **its date of acquisition** because it was acquired through a transfer of insurance contracts or a business combination.

The following differences can arise between **Contract A** and **Contract B** depending on the terms of the insurance contract.

Example types of contracts	Contract A (Inception date characteristics)	Contract B (Date of acquisition characteristics)
Short-term insurance contracts in their settlement period with long-tail claims	Generally **measured under the PAA**. At the date of acquisition, these contracts are liabilities for incurred claims (LIC) from the issuer's perspective	Generally **measured under the GMM** because the insured event is the adverse development of the incurred claims – i.e. liabilities for remaining coverage (LRC) that include a CSM or loss component
Direct participating insurance contracts with little or no remaining participation	Measured as **VFA** contracts	Generally measured as **GMM** contracts
Contracts with significant insurance risk at inception that no longer exists at the date of acquisition	Measured under **IFRS 17**	Classified and measured under applicable standard(s) – e.g. **IFRS 9 *Financial Instruments***

03 Identifying a business combination

Some of the accounting for insurance contracts acquired depends on whether they are acquired in:

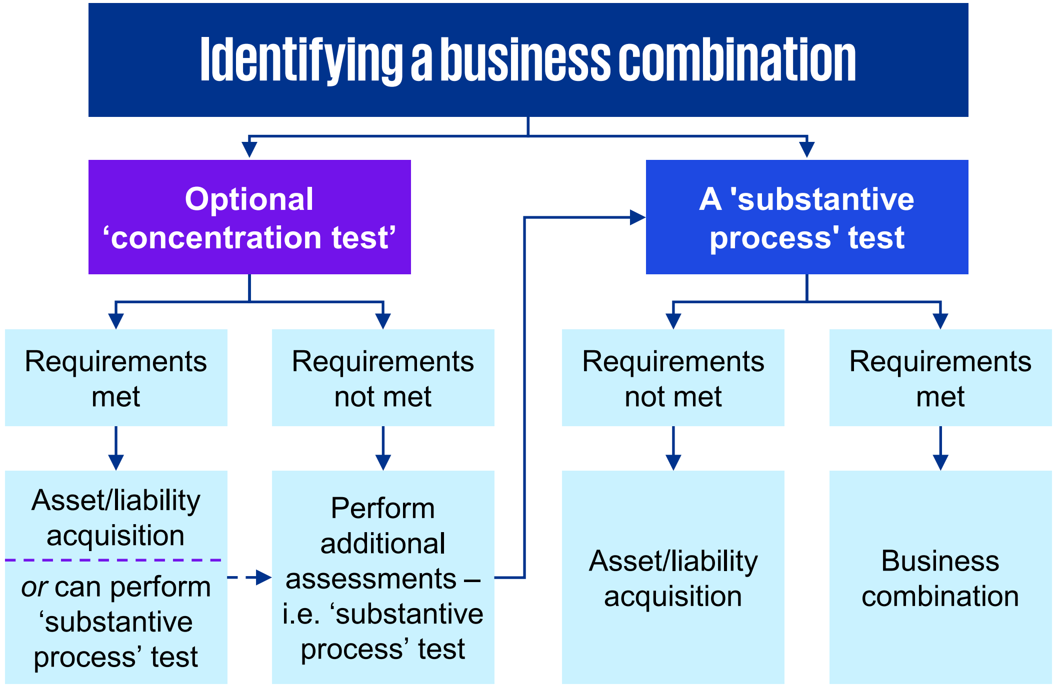
- a business combination in the scope of IFRS 3; or
- a transfer of insurance contracts.

Under IFRS 3, the following tests are used to determine whether assets acquired and liabilities assumed constitute a business.

†Optional 'concentration test'

A permitted simplified assessment to determine whether a set of activities and assets may not be a business.

This test alone cannot determine whether there is a business combination.



A 'substantive process' test

A test to determine whether a transaction constitutes a business combination.

A transaction is a business combination when the acquired set of activities and assets comprises at least an input and a substantive process that together significantly contribute to the ability to create outputs.

† The 2018 amendment to IFRS 3 amended the definition of a business and added the optional concentration test in IFRS 3.B7A-C.

What might constitute a substantive process?

Acquiring an organised workforce to manage the customer relationships and underwriting process would generally meet the criteria in the substantive process test.

04 Measurement – Transfers vs business combinations

	Transfers	Business combinations
General principle for assets and liabilities	• Identify and recognise the identifiable assets acquired and liabilities assumed, including intangible assets in the scope of IAS 38. • Generally, the identifiable assets and liabilities are measured at cost in a transfer (i.e. consideration transferred) and at fair value in a business combination.	
	• Allocate **cost** to individual assets and liabilities based on their **relative fair values** as at the date of acquisition. • No **goodwill or gain on bargain purchase**.	• Determine **fair values** at the date of acquisition and use to measure the individual assets and liabilities. • **Goodwill or gain on bargain purchase** may arise.
Measuring insurance contracts	• **Use consideration received or paid** for the contracts as a proxy for premiums received (i.e. allocate consideration to the contracts based on their **relative fair value**).	• Use consideration received or paid as a proxy for premiums received. • Consideration is based on the **fair value** of the contracts as at the date of the acquisition.
Onerous insurance contracts	• Recognise the difference in fulfilment cash flows and the consideration received or paid (i.e. relative fair value) as a **loss immediately in profit or loss**.	• Recognise the difference in fulfilment cash flows and the consideration received or paid (i.e. fair value) as **part of the goodwill or gain on a bargain purchase**.
Insurance acquisition cash flows (IACF) assets	• Recognise at fair value at the date of the transaction for the rights to obtain future insurance contracts: – that are renewals; and – other than renewals, after the date of the transaction, without paying again IACFs that the acquiree has already paid and that are directly attributable to the related portfolio of insurance contracts.	

What if the sum of individual fair values of identifiable assets and liabilities differs from the transaction price in a transfer?

In these cases, the IFRS Interpretations Committee's November 2017 decision would apply to determine the initial measurement of the individual assets and liabilities.

05 Parent and subsidiary reporting

A parent company and a subsidiary that both report under IFRS® Accounting Standards may classify and measure acquired insurance contracts differently.

For example, if a parent company acquired a subsidiary that previously issued insurance contracts, then:

- the subsidiary will continue to apply the general requirements of IFRS 17 to its insurance contracts; and
- the **parent company** will apply the specific requirements for insurance contracts acquired **as at the date of acquisition.**

This means that these contracts may be:

- classified and measured differently in the parent company and subsidiary; and
- measured differently if the parent company and subsidiary have different accounting policies.

These differences may be significant and require additional explanation to stakeholders.

Contract A

- Issued by subsidiary
- Classified and measured **at inception (or modification)**

Contract A

- Acquired by parent
- Classified and measured **at date of acquisition**

Is a 'dual CSM' required?

A 'dual CSM' applies when the measurement of the CSM for the same group of insurance contracts differs between the parent and the subsidiary. This will impact group data and system requirements and may require explanation to stakeholders.

06 Business combinations under common control

Some business combinations may occur under common control – e.g. in restructurings, initial public offerings, legal mergers and amalgamations.

Business combinations under common control (BCUCC) are business combinations in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the combination.

They are scoped out of IFRS 3 and IFRS Accounting Standards do not specify how to account for them.

The absence of accounting guidance has resulted in diversity in how the receiving company accounts for the transaction in its financial statements – some companies use the acquisition method (i.e. apply IFRS 3) and others use a book-value method.

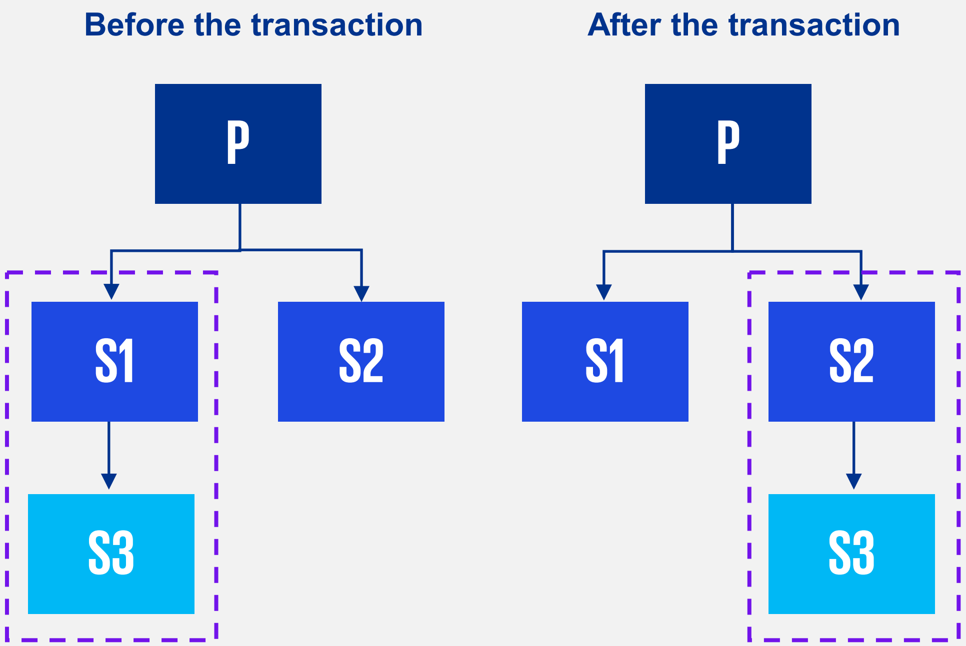
If the receiving company uses the acquisition method, then BCUCC may still create differences in classification and measurement of acquired insurance contracts.

What if there is a transfer under common control?

For transfers of insurance contracts under common control – i.e. transfers that are not business combinations – the requirements of IFRS 17 apply. However, any potential impacts of transactions with shareholders need to be considered in determining the appropriate accounting.

Example of a business combination under common control

Each of P, S1, S2 and S3 are businesses. Control of S3 is transferred from S1 to S2 (the receiving company). S2 and S3 (the combining businesses) are ultimately controlled by P before and after the transaction.



07 Transition reliefs and exceptions

IFRS 17 is generally applied retrospectively, including to business combinations and to transfers of insurance contracts.

If this is impracticable, then companies may apply either a modified retrospective approach or a fair value approach.

Both transition approaches include various reliefs under **IFRS 17**, including a **transition relief for acquired claim liabilities**.

If insurance contracts are **acquired before the date of initial application** of IFRS 17, then a **classification exception in IFRS 3 applies.**

	IFRS 17 transition relief	IFRS 3 classification exception
Relief/ exception	A liability for settlement of claims incurred before an insurance contract was acquired may be **classified as LIC and not have a CSM or loss component**	IFRS 3 requires insurance contracts acquired to be **classified as an insurance contract** based on the contractual terms and other factors **at the inception (or modification) of the contract**
Applies for	Both transfers of insurance contracts and business combinations	**Business combinations**
When	**Before date of transition** to IFRS 17	**Before date of initial application** of IFRS 17

Date of transition

1 January 2022[1]

Date of initial application

1 January 2023[1]

Transition reliefs may apply

IFRS 3 classification exception applies

1. Assuming IFRS 17 is initially applied from 1 January 2023 and one year of adjusted comparative information is presented.

08 Impact on transition to IFRS 17

On transition to IFRS 17, **insurance contract assets and liabilities are adjusted.**

Balances related to these assets and liabilities should also be adjusted to comply with IFRS 17's recognition and measurement requirements, including:

- intangible assets previously recognised under IAS 38; and
- deferred tax recognised under IAS 12 *Income Taxes.*

These balances may relate to both previous transfers of insurance contracts and business combinations.

Is goodwill adjusted for previous business combinations?

If IFRS 17 were applied to business combinations that occurred before the date of transition to IFRS 17, then a different goodwill amount may have been determined. Under the specific transition requirements of IFRS 17, the carrying amount of goodwill (if there is any) should not be adjusted.

Adjusting intangible assets on transition to IFRS 17

If there is double counting of the same rights to obtain expected future contracts when IFRS 17 is applied retrospectively, then intangible assets should be adjusted on transition to IFRS 17. Double counting may occur due to:

Changes in the contract boundary of insurance contracts

IAS 38 intangible assets may have been previously recognised for the rights to obtain expected future contracts. If these rights are included in the contract boundary under IFRS 17, then the intangible assets should be adjusted.

Recognition of insurance acquisition cash flow assets

IFRS 17 requires recognition of a separate asset for insurance acquisition cash flows. If the rights to obtain expected future contracts included in this asset are already included in previously recognised IAS 38 intangible assets, then the previously recognised intangible assets should be adjusted.

09 Business combinations before initial application of IFRS 17

The IFRS 3 classification exception applies only before the date of initial application of IFRS 17.

When applying this exception, insurance contracts are classified as insurance contracts at the date of inception (or modification), not at the date of acquisition.

However, this classification exception applies to classification as an insurance contract only – i.e. if a contract is in the scope of IFRS 17. **It should not be applied to other assessments required by IFRS 17.**

For some acquired contracts, this could mean that contracts without significant insurance risk at the date of acquisition are measured under IFRS 17.

		Before initial application (1 January 2023)	After initial application (1 January 2023)
General requirements	**Classification as an insurance contract**	Based on **the date of inception (or modification)**	Based on the **date of acquisition**
General requirements	**Measurement in the scope of IFRS 17**	Based on the **date of acquisition**	Based on the **date of acquisition**
Example	**Contracts with significant insurance risk at inception, which no longer exists at the date of acquisition**	Should be measured under **IFRS 17**	Classified and measured under applicable standard(s) – e.g. **IFRS 9**

Date of transition
1 January 2022[1]

Date of initial application
1 January 2023[1]

IFRS 3 classification exception applies

1. Assuming IFRS 17 is initially applied from 1 January 2023 and one year of adjusted comparative information is presented.

10 Next steps

Identify past acquisitions

… including identifying the date of acquisition and the information you have available to determine whether transition reliefs apply to you.

Assess systems and processes

… to ensure they have the infrastructure to account for these contracts in a business-as-usual environment. This may include a separate set of records (i.e. a 'dual CSM') for subsidiary and group reporting.

Plan for these changes

… including educating stakeholders on the financial impacts of the new requirements when preparing for future transfers of insurance contracts or business combinations.

Involve specialists

… because transfers of insurance contracts or business combinations are often unique and bring with them new issues. Ensure the appropriate specialists are involved to comprehensively address IFRS 17's requirements.

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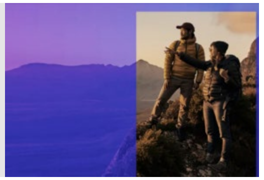

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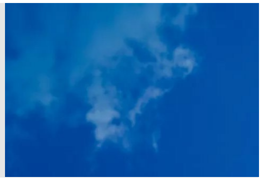

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