IFRS 17 for non-insurers

Do you have an insurance contract in the scope of IFRS 17?

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Get ready for IFRS 17

"The new standard will apply to contracts issued. This means that all companies could be affected, not just insurers."

From 2023, the new insurance standard, IFRS *17 Insurance Contracts*, will apply for all companies, not just insurers. This is because it applies to contracts, regardless of the issuer.

What's the issue?

- Some non-insurers could issue a contract to which IFRS 17 will apply – e.g. product breakdown contracts or warranties.
- IFRS 17 contains more detailed and complex prescriptive guidance for recognition, measurement and disclosure than IFRS 4 *Insurance Contracts*.

What's the impact?

- IFRS 17 makes some changes to the definition of an insurance contract and adds new scope exemptions.
- Moreover, whether a contract is or is not an insurance contract and in scope could change.
- The accounting for contracts in the scope of IFRS 17 may be much more challenging than IFRS 4 *Insurance Contracts*.

What's next?

- Understand whether you issue any insurance contracts (even if they are not called insurance contracts).
- Understand whether these contracts are included in any of the IFRS 17 scope exemptions.
- Choose whether to adopt scope exemptions that are optional for those contracts to which IFRS 17 will apply.

IFRS 17 – Are you affected?

Do you have an insurance contract under IFRS 17?

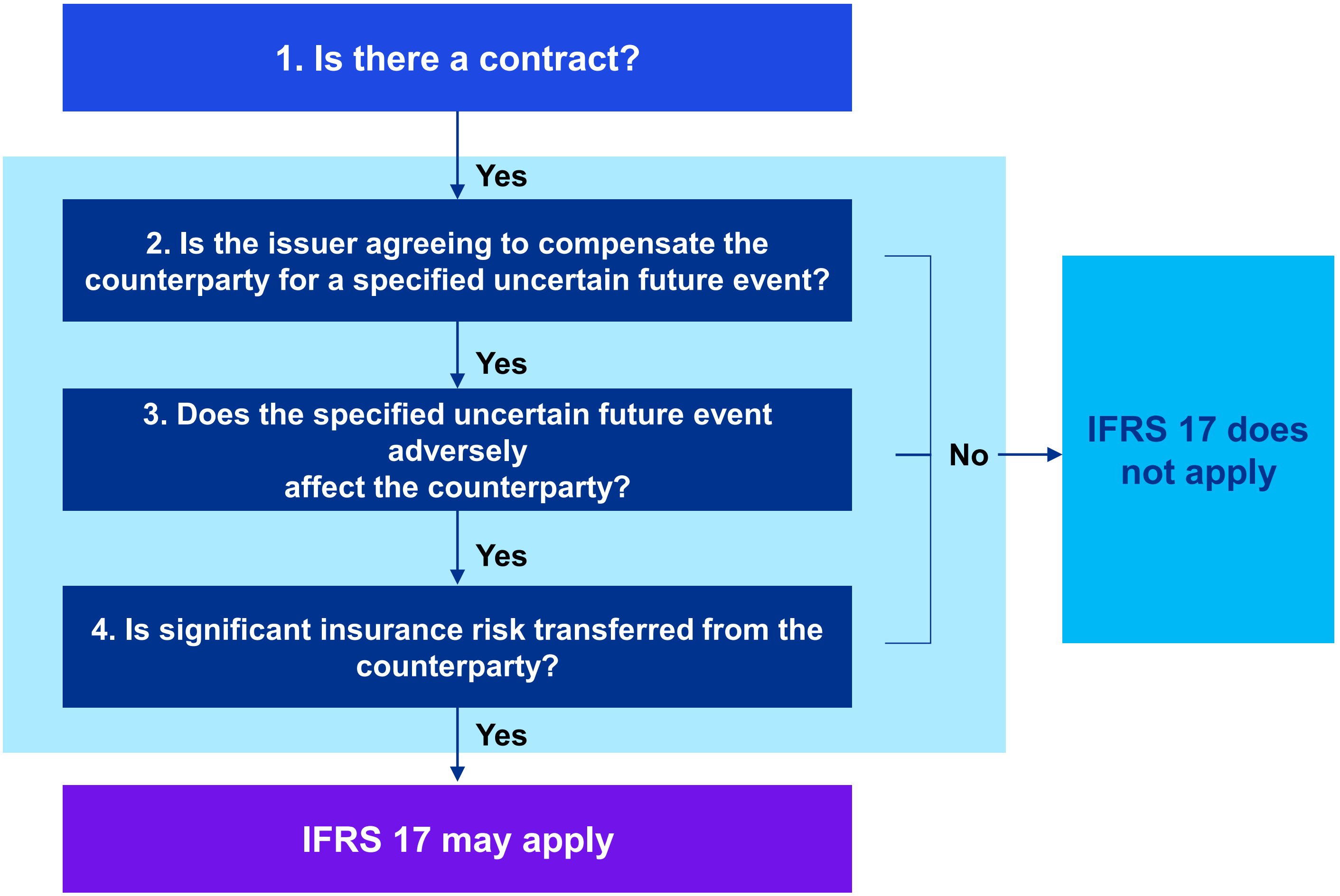
- Product or extended warranties
- Performance guarantees
- Other financial guarantees
- Loan contracts – e.g. with waiver on death
- Credit cards
- Boiler breakdown contracts
- Guarantees between group companies – e.g. parent and subsidiary
- Mobile device replacement contracts
- Lease contracts
- Hotel management services contracts

Look at your contracts now to assess whether you have issued[1] an insurance contract in the scope of IFRS 17.

Applying the flowchart on the next page will help you.

[1] IFRS 17 applies only to insurance contracts issued and reinsurance contracts held. It does not apply to insurance contracts held.

Do you have an insurance contract?



IFRS 17 refers to a 'policyholder', which is the term insurers typically use for their customers. It does not matter whether the contract refers to a policyholder or a different title for another party to the contract – e.g. counterparty.

1. Is there a contract?

Step 1 is similar to the revenue and leases standards – i.e. assess whether there is a contract.

A contract is an agreement between two or more parties that creates **enforceable rights and obligations**. Enforceability is a matter of law.

If the agreement between the issuer and the counterparty is not enforceable, then an insurance contract does not exist.

Contracts can be written, oral or implied by an company's customary business practices. Implied terms also include those imposed by law or regulation.

2. Compensating for a specified uncertain future event?

Step 2 requires there to be **compensation for a specified uncertain future event**, which could be a cash payment or a payment in kind – e.g. repairing or replacing a broken product.

The **future event** for which the counterparty is being compensated **is required to be uncertain at inception of the contract**. This uncertainty surrounding the insured event is the essence of an insurance contract.

2. Is the issuer agreeing to compensate the counterparty for a specified uncertain future event?

- **Yes** → **IFRS 17 may apply**
- **No** → **IFRS 17 does not apply**

Types of uncertainty in insurance contracts

- Probability of an insured event occurring – e.g. car breakdown cover has risk that the car will break down
- Timing of occurrence – e.g. timely compliance of agreed performance
- How much will be paid if the insured event occurs – e.g. a payment specified in a performance guarantee contract

3. Does the specified event adversely affect the counterparty?

In Step 3, a specified uncertain future event needs to adversely affect the counterparty. This means that:

- **IFRS 17 might apply:** for example, when a contract compensates a building owner for damage to the building from an earthquake. This is because the building owner is adversely affected by the damage to their building.
- **IFRS 17 would not apply:** for example, in a weather derivative contract where a company will make a payment if there is an earthquake. This is because the earthquake need only occur for the contract to pay; it does not require the earthquake to cause damage to the customer's building for payment to occur.

3. Does the specified uncertain future event adversely affect the counterparty?

- **Yes** → **IFRS 17 may apply**
- **No** → **IFRS 17 does not apply**

4. Is significant insurance risk transferred?

Insurance risk is any risk other than financial risk

Non-financial risk is a risk that is specific to a party to the contract – e.g. the occurrence or non-occurrence of a fire that damages or destroys a party's asset.

Insurance risk is the (non-financial) risk the issuer accepts from the counterparty, and is a risk to which the counterparty was already exposed. Any new risk created by the contract for either party is not insurance risk.

When is insurance risk significant?

Insurance risk is considered significant if the issuer could be required to pay significant additional amounts beyond what it would pay if the insured event had not occurred and it could suffer a loss as a result. The assessment of significance excludes scenarios that have no commercial substance.

For example, a contract requires a counterparty to be reimbursed for the value of a property it owns in the event that the property is destroyed by a hurricane. The likelihood of a hurricane destroying a building is low, but the payment could be substantial if the event occurs. This contract contains significant insurance risk.

4. Is significant insurance risk transferred from the counterparty?

Yes → **IFRS 17 may apply**

No → **IFRS 17 does not apply**

- Significance is not based on the likelihood of the event occurring; it is based on what could be paid and if it results in a loss.
- Significance is assessed from the issuer's perspective.
- Significance is assessed at an individual contract level.
- The time value of money is considered when determining significance.
- Contracts that expose the issuer to both financial risk and significant insurance risk are insurance contracts.

Illustration: Applying the four-step process

Maintenance contract

- A company provides a maintenance contract in which it agrees to repair specified equipment after a malfunction for a fixed fee. This agreement is between two or more parties and creates enforceable rights and obligations.
- The fixed service fee is based on the expected number of malfunctions for the customer's specified equipment.
- The cost to repair the specified equipment could significantly exceed the fixed service fee received in some circumstances.

1. Is there a contract?

Yes

2. Is the issuer agreeing to compensate the counterparty for a specified uncertain future event?

Yes – because the company has agreed to compensate the customer if the machine malfunctions, which is an uncertain future event.

3. Does the specified uncertain future event adversely affect the counterparty?

Yes – because malfunctioning equipment would adversely affect its owner.

4. Is significant insurance risk transferred from the counterparty?

Yes – because if the specified equipment breaks down, the cost could be significantly more than the service fee received for that contract. This creates a significant insurance risk.

However, if the fee varied based on the maintenance to be performed to reflect the cost of the repairs plus a margin, then it would not be an insurance contract. This is because the maintenance company would not be taking on significant insurance risk.

IFRS 17 may apply[1]

[1] Fixed-fee service contracts that are determined to be insurance contracts can be accounted for under IFRS *15 Revenue from Contracts with Customers*, if certain conditions are met (see page 12). This is a contract-by-contract choice.

Your questions answered

Are there contracts that are specifically exempt from the scope of IFRS 17?

Yes, as follows.

Type of contract	Applicable IFRS® Standard
Warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer	IFRS 15, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
Employer's assets and liabilities	IFRS 2 *Share-based Payment*, IAS 19 *Employee Benefits*, IAS 26 *Accounting and Reporting by Retirement Benefit Plans*
Contractual rights/obligations contingent on the future use of, or right to use, a non-financial item – e.g. some licence fees, royalties, variable and other contingent lease payments, and similar items	IFRS 15, IAS 38 *Intangible Assets*, IFRS 16 *Leases*
Residual value guarantees provided by a manufacturer, dealer or retailer and a lessee's residual value guarantees when they are embedded in a lease	IFRS 15, IFRS 16
Contingent consideration payable or receivable in a business combination	IFRS 3 *Business Combinations*
Credit card contracts, or similar contracts that provide credit or payment arrangements, that meet the definition of an insurance contract if, and only if, the company does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer. IFRS 17 is applied to any contractual insurance component that is separated in accordance with IFRS 9.	IFRS 9 *Financial Instruments* and other applicable standards

Your questions answered (cont.)

Are financial guarantee contracts in the scope of IFRS 17?

It depends.

A financial guarantee contract grants the counterparty the right to be reimbursed by the issuer for a loss that it incurs when a specified debtor fails to make a payment when it is due under the terms of a debt instrument. These types of guarantee usually meet the definition of an insurance contract.

When a company first applies IFRS 17, it may irrevocably elect to apply IFRS 17 to its existing issued financial guarantee contracts on a contract-by-contract basis if it has:

- previously explicitly asserted that it regards such contracts as insurance contracts; and
- accounted for them on that basis – i.e. as insurance contracts.

If IFRS 17 is not applied, then an issued financial guarantee contract is accounted for under the financial instruments standards (IFRS 7 *Financial Instruments: Disclosures*, IFRS 9, IAS 32 *Financial Instruments: Presentation*).

The same election may be available on initial recognition of a new financial guarantee contract.

Non-insurers should consider whether they have any contracts that may meet the definition of a financial guarantee. For example, financial guarantees may be common between a parent and subsidiary. If any contracts were previously accounted for under IFRS 4, then there may be significant changes in how these contracts are measured.

Your questions answered (cont.)

A company has issued a fixed-fee service contract that it currently accounts for under IFRS 15. The contract meets the definition of an insurance contract under IFRS 17. Will IFRS 17 apply to the contract?

It depends.

Fixed-fee service contracts that meet the definition of an insurance contract may be accounted for under IFRS 15 if:

- there is no assessment of risk associated with an individual customer in setting the price of the contract with that customer – i.e. the price is based on a collective assessment of customers;
- the contract compensates the customer by providing services, rather than by making cash payments to the customer; and
- the insurance risk transferred by the contract arises primarily from the customer's use of services rather than from uncertainty over the cost of those services.

A company makes an irrevocable election on a contract-by-contract basis whether to account for these contracts (i.e. those that meet all of the above criteria) under IFRS 17 or IFRS 15.

Possible examples of such contracts may be road-side assistance contracts, boiler breakdown services and mobile phone repair and replacement contracts. Companies will need to assess whether the exemption criteria are met.

Are performance guarantees/surety bonds in the scope of IFRS 17?

It depends.

To determine whether these types of contracts are in the scope of IFRS 17, it is important to understand whether they transfer significant insurance risk.

For example, a company provides a performance bond to a property owner to compensate the property owner for any delay in the construction of a high-rise building caused by the builder's poor performance. The amount of compensation could be significant. This is an insurance contract because:

- there is a specified uncertain future event (i.e. whether the construction company will fulfil their obligations to construct the building on time) that could adversely affect the property owner if it occurs;
- the risk covered is significant insurance risk – i.e. a risk that is specific to a party to the performance bond contract (the property owner); and
- that risk is significant.

Your questions answered (cont.)

What other types of contracts might a company need to consider when assessing what might be in the scope of IFRS 17?

Other contract types may include:

- **Loan contracts and other contracts with limited compensation:** Certain loans may meet the definition of an insurance contract if they transfer significant insurance risk. If a contract limits the compensation for insured events to the amount otherwise required to settle the counterparty's contractual obligation and the contract is not specifically exempted from IFRS 17, then a company can choose to apply IFRS 9 or IFRS 17. This choice is made (irrevocably) on a portfolio of insurance contracts basis.
- **Lease contracts:** Certain lease contracts could contain insurance components that a company might need to separate from the lease contract.
- **Contracts issued by captive insurers:** Some non-insurers may have captive insurance companies to manage (some of) the insurance risk within a consolidated group and enter into contracts to transfer risks to an external insurer. Such captive insurance companies probably issue insurance contracts that are in the scope of IFRS 17.

For example, a bank issues a loan with a waiver on death to a customer – e.g. a retail mortgage with life insurance coverage. The consideration for the life insurance coverage is part of the overall interest rate charged on the mortgage and the outstanding balance of the mortgage is waived if the borrower dies.

This loan meets the definition of an insurance contract under IFRS 17. However, because the insurance coverage in the contract is for the obligation of the counterparty/borrower to repay the loan and its accrued interest, the compensation for insured events is limited to the amount otherwise required to settle the counterparty's contractual obligation.

Therefore, the bank can make an irrevocable election to apply either IFRS 9 or IFRS 17 to these types of contracts.

What's next?

Your contracts

- Consider whether you have contracts that might meet the definition of an insurance contract.

Accounting policies/elections

- Consider whether your contracts will be in the scope of IFRS 17.
- Understand how they might be affected by IFRS 17.
- Consider whether you may need to make any elections when deciding how to account for those contracts.

Accounting systems and processes

- Consider whether you have the appropriate controls and processes in place.
- Assess whether there are accounting implications under IFRS 17 for any new contracts.

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At KPMG, we have a top-down and business-focused approach to IFRS 17 implementation to help you accelerate progress towards your goals confidently and securely. This approach is tailored to help answer the questions that are important to you, while building on the knowledge of KPMG professionals who:

- have a hypothesis-driven approach, starting top-down rather than bottom-up with a gap analysis. This can enable design decisions to be taken earlier, reducing demands on resources;
- bring deep market insights from advising leading insurers on IFRS 17 and IFRS 9 and the experience from this work to help accelerate thinking in complex aspects of the new requirements;
- understand that one size does not fit all, enabling clear communication of the issues that matter to you; and
- leverage proprietary tools and accelerators for your impact assessment, tailoring our approach to meet your needs and aspirations, whether quick wins, cost savings or efficient financial and regulatory reporting, as well as improved teamwork and other benefits.

KPMG firms offer you insights and actively promote knowledge transfer to your people from the outset, so that you have a sound base of expertise to deliver new ways of working.

Contact us to learn more about how KPMG firms can help unlock value from your IFRS 17 programme or visit home.kpmg/ifrs17.

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