Insurance Contracts

New on the Horizon

Amendments to IFRS®17

July 2019

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Contents

Time to up the pace

Now that we have a complete picture of what the final standard will look like, it's time to step up the pace of implementation.

Implementing IFRS 17 *Insurance Contracts* has clear benefits – particularly increased transparency and greater comparability regarding insurers' financial health and performance. However, certain concerns and challenges have arisen over the new standard's implementation.

The proposed amendments to IFRS 17 target these issues in seven important areas. They also propose a one-year deferral of IFRS 17's effective date to 1 January 2022 and a one-year extension of the exemption from applying IFRS 9 *Financial Instruments* granted to insurers meeting certain criteria.

There's a lot here for insurers to be pleased about. The extra year would give you much-needed time to complete your IFRS 17 implementation projects and the amendments would provide practical solutions to significant challenges that you may have encountered.

But it's crucial to remember that – even with the amendments – implementing IFRS 17 will still be a huge challenge requiring changes to the data that you gather and your systems, processes and controls.

This *New on the Horizon* provides an overview of the proposed amendments. It also includes examples and our insights to help you assess the potential impacts on your implementation project as you prepare for the effective date.

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1 Key facts and impacts

The Board is proposing a one-year deferral of IFRS 17's effective date to 1 January 2022 and amendments in seven areas.

1.1 Purpose of the amendments

Having monitored the implementation of IFRS 17, the International Accounting Standards Board (the Board) identified 25 specific areas of the standard in which stakeholders had highlighted their concerns and implementation challenges.

The Board set criteria for proposing any amendments to IFRS 17[1] and subsequently decided to propose a one-year deferral of the effective date and amendments in seven of the 25 areas. The Board also decided to make several minor amendments to clarify the wording of the standard or address unintended consequences.

1.2 Effective date deferred to 2022

The Board is proposing that the effective date of IFRS 17 – and the fixed expiry date of the temporary exemption from applying IFRS 9 granted to insurers meeting certain criteria – be deferred by a year to 1 January 2022.

1.3 Amendments in seven important areas

Area	Key facts	Key impact
Scope	Preparers of financial statements would no longer be required to apply IFRS 17 to certain credit cards and loans that provide insurance coverage.	Reduces IFRS 17 implementation costs for many credit card issuers and lenders.
Allocating insurance acquisition cash flows	Insurers would be required to allocate part of the insurance acquisition cash flows that are directly attributable to newly issued contracts to expected contract renewals.	Newly issued contracts with high insurance acquisition cash flows – e.g. initial commissions – are less likely to be onerous.

1. For more information, read our web article: IFRS 17 – IASB considers amending the standard.

Area	Key facts	Key impact
Accounting for acquired claims liabilities on transition	The Board is proposing to amend the transition requirements for claims liabilities acquired by an entity in a business combination or portfolio transfer.	Provides practical relief by eliminating the challenge of recording claims liabilities in two different ways – as IFRS 17 currently requires – if the information is not available.
Accounting for investment services in an insurance contract	The profit recognition pattern for insurance contracts would be amended to reflect the provision of insurance coverage *and* any investment services.	Better aligns the accounting with the services provided.
Reinsurance of onerous contracts	The accounting would change for proportionate reinsurance contracts held that cover losses on underlying insurance contracts that are onerous on initial recognition.	Addresses accounting mismatches that arise on initial recognition when an insurer reinsures onerous contracts using proportionate reinsurance coverage.
Risk mitigation for direct participating contracts	The risk mitigation option applicable to direct participating contracts would be expanded, allowing insurers to use it when reinsurance contracts held – as well as derivatives – are used to mitigate financial risk.	Reduces accounting mismatches that arise when reinsurance contracts held are used to mitigate the financial risk of direct participating contracts.
Presentation of assets and liabilities	Insurance contracts would be presented in the statement of financial position at the portfolio level – a higher level than is currently required.	Provides practical relief to insurers that may find it difficult to allocate cash flows to individual groups of insurance contracts.

1.4 High-level information on the proposals

Visit home.kpmg/ifrs17amendments for more high-level information on the proposals, including video content and a downloadable PDF guide.

2 Effective date of IFRS 17

The Board is proposing a one-year deferral of the effective date of IFRS 17 and the fixed expiry date of the temporary exemption from applying IFRS 9 granted to insurers meeting certain criteria.

2.1 Deferral to 2022

2.1.1 What's the issue?

IFRS 17.C1

As originally issued, IFRS 17 applies for annual periods beginning on or after 1 January 2021. Earlier adoption is permitted for entities that apply IFRS 9 and IFRS 15 *Revenue from Contracts with Customers* on or before the date of initial application of IFRS 17.

IFRS 17.C2

The date of initial application is the start of the annual reporting period in which an entity first applies IFRS 17.

IFRS 4.20A–20B, 35B–C

IFRS 4 *Insurance Contracts* includes a temporary exemption from applying IFRS 9 and an overlay approach to presentation.[2] From the date of initial application of IFRS 17, these approaches are no longer available and IFRS 9 is applied, without delay or adjustment. The temporary exemption is available to reporting entities whose activities are predominantly connected with insurance (subject to certain criteria being met) and includes a fixed expiry date – i.e. 1 January 2021.

Effective date of IFRS 17

Some stakeholders expressed the view that there is insufficient time to implement IFRS 17 before its January 2021 effective date. Many argued that at least a one-year deferral would be helpful.

Some stakeholders expressed concerns that deferring the standard further could increase the costs of implementation without a corresponding benefit. Other stakeholders noted that some external providers might need more time to develop the necessary IT solutions.

Temporary exemption from applying IFRS 9

Some stakeholders suggested that if IFRS 17's mandatory effective date is to be postponed, then the Board should also revise the fixed expiry date of the temporary exemption from applying IFRS 9. This would avoid preparers and users of financial statements experiencing two sets of major accounting changes in a short period of time. If the expiry date remained unchanged, then insurers would be required to apply IFRS 9 by 2021 at the latest and IFRS 17 by 2022, resulting in significant effort for both preparers and users of financial statements.

2. For an in-depth discussion on these approaches, see our First Impressions: Amendments to IFRS 4.

2.1.2 What's the Board proposing?

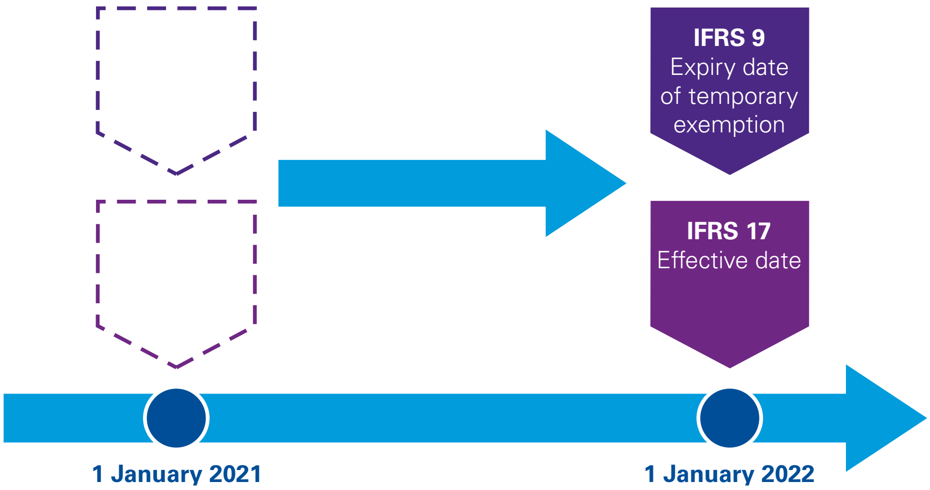
The Board acknowledged that uncertainty about the effects of any amendments proposed could disrupt the progress of preparers' implementation. This disruption could occur even if any amendments served to ease implementation.

The Board also agreed that, if IFRS 17's effective date is deferred by one year, then the benefit of extending the fixed expiry date of the temporary exemption would outweigh the disadvantage of further delay to the improved information that would result from insurers applying IFRS 9.

ED.C1, D, BC110–BC118

Therefore, the Board is proposing that:

- IFRS 17's effective date be deferred to 1 January 2022; and
- the temporary exemption from applying IFRS 9 be extended to 1 January 2022.



Expediting implementation efforts

The Board's proposal means that all entities preparing financial statements under IFRS would be required to apply both IFRS 9 and IFRS 17 for annual periods beginning on or after 1 January 2022.

Despite the proposed deferral of IFRS 17's effective date, implementing IFRS 17 continues to be a complex and significant undertaking.

It is important for insurers to step up the pace of their implementation efforts to reach the finish line with systems and processes tested and results understood by management and investors.

Restating comparatives

IFRS 9.7.2.1, 17.C3

Entities are generally required to apply both IFRS 9 and IFRS 17 retrospectively, subject to some exceptions.

IFRS 9.7.2.1, 7.2.15

Specifically, IFRS 9 provides an exemption from restating comparative information when IFRS 9 is initially applied. An entity may choose to restate comparative information if, and only if, it is possible without the use of hindsight. Furthermore, an entity is prohibited from applying IFRS 9 to items that have already been derecognised at the date of initial application of IFRS 9. By contrast, IFRS 17 does not contain similar requirements.

IFRS 17.BC387–BC389

Some stakeholders expressed concerns about the complexities that might arise from the different transition requirements when the two standards are initially applied at the same time. However, the Board noted that those differences resulted from different circumstances when those requirements were developed and they had already been subject to extensive deliberation and consultation. Therefore, the Board did not propose any amendments to the standards in this area.

Accordingly, information about financial assets and financial liabilities derecognised before the date of initial application of IFRS 9 – i.e. those derecognised during the comparative period – continues to be reported in accordance with IAS®39 *Financial Instruments: Recognition and Measurement*, even when an entity elects to restate comparative information to reflect the adoption of IFRS 9. This means that the comparative information could contain a mixture of:

- IAS 39 accounting for items that are derecognised before the date of initial application of IFRS 9; and
- IFRS 9 accounting for financial instruments that continue to be recognised at the date of initial application.

Our Guide to annual financial statements: IFRS 17 and IFRS 9 – Illustrative disclosures for insurers illustrates the presentation of profit or loss and other comprehensive income (OCI) when IFRS 17 and IFRS 9 are initially applied at the same time.

3 Scope of IFRS 17

Under the Board's proposals, preparers of financial statements would no longer be required to apply IFRS 17 to certain credit cards and loans that provide insurance coverage.

3.1 Credit cards that provide insurance coverage

3.1.1 What's the issue?

Some credit card contracts may provide insurance coverage and transfer significant insurance risk from the cardholder.

Example 1 – Credit card that provides insurance coverage

Fact pattern

Credit Card Issuer C provides insurance coverage for purchases that the cardholder makes using the credit card. C would pay the cardholder for claims resulting from a supplier's misrepresentation or breach of contract.

Under this arrangement, C either:

- charges no fee to the cardholder for this service; or
- charges an annual fee that does not reflect an assessment of the insurance risk associated with that individual cardholder.

Analysis

The credit card contract contains both insurance and non-insurance components.

This could pose a challenge for C because:

- the requirements in IFRS 17 for separating non-insurance components differ from those in IFRS 4, as explained in the table below; and
- IFRS 4 is less prescriptive about how any insurance component is measured.

IFRS 4.10–12

IFRS 17.10–13

Standard	Requirements for separating non-insurance components (excluding embedded derivatives)
IFRS 4	Permits an insurer to separate a loan component from an insurance contract and apply IFRS 9 (or IAS 39) to the loan component.
IFRS 17	Generally requires IFRS 17 to be applied to the whole contract that transfers significant insurance risk. Separation is permitted only in narrower circumstances than under IFRS 4. Specifically, an insurer separates investment components and goods or non-insurance services components if they are distinct.

Stakeholders are concerned that credit card issuers that currently account for a loan or a loan commitment in a credit card contract under IFRS 9 (or IAS 39) would need to change the accounting for those contracts that transfer significant insurance risk when IFRS 17 becomes effective – only a short time after having incurred costs to develop a new credit impairment model to comply with IFRS 9.

3.1.2 What's the Board proposing?

ED.7(h), BC9–BC17, BC23–BC30

The Board is proposing to exclude from the scope of IFRS 17 credit card contracts that provide insurance coverage if the price set by the card issuer for a customer does not reflect an assessment of the insurance risk associated with that individual customer.

This proposal would reduce IFRS 17 implementation costs for many credit card issuers.

Credit cards outside the scope of IFRS 17

Additional scope exclusion

A company issuing a credit card contract that provides insurance coverage, but that would be excluded from the scope of IFRS 17 under this proposed amendment, would need to assess which standard(s) might apply to the different components of the arrangement.

For example:

- a loan or loan commitment and interest charged might fall under IFRS 9;
- revenue for supplying goods and other services provided by the card issuer might fall under IFRS 15; or
- a contract that becomes onerous and is either in the scope of IFRS 15 or is not covered by another standard might fall under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

IFRS 9.B4.1.13.E

The insurance coverage provided under the credit card arrangement might arise only as a result of law or regulation. Therefore, payment obligations related to the insurance coverage might be disregarded when analysing whether the contractual terms give rise to cash flows that are solely payments of principal and interest under IFRS 9. (For example, IAS 37 might apply to such obligations.)

Other credit card features

Some credit cards might have features that are not covered by the proposed amendment, but may be outside the scope of IFRS 17 for other reasons.

Here are some examples.

- The credit card issuer merely acts as an agent in selling insurance provided by a third party insurer.

IFRS 17.8

- The insurance coverage meets the specified conditions for a fixed-fee service contract under IFRS 17 and therefore may be accounted for under IFRS 15.
- The insurance coverage provides only for the settlement of the customer's obligation created by the contract – e.g. a waiver of the loan balance of the credit card if the customer dies – and would be captured by the proposed policy choice of applying either IFRS 9 or IFRS 17 to loans that transfer significant insurance risk (see Section 3.2).
- The credit card contract features a 'chargeback' mechanism, under which the card issuer processes claims from cardholders requesting a refund of actual amounts paid using the credit card in respect of non-delivered goods or services.

3.2 Loans that transfer significant insurance risk

3.2.1 What's the issue?

Some loan contracts may transfer significant insurance risk – e.g. a waiver of some or all of the payments due if a specified uncertain future event adversely affects the borrower. Examples include mortgages with a waiver on death, some student loans and lifetime mortgages (also known as equity release or reverse mortgages).

Similar to credit card contracts that provide insurance coverage (see 3.1.1), some lenders currently account for these contracts under IFRS 4 by separating the loan component from the insurance contract, then applying IFRS 9 (or IAS 39) to the loan component. This practice would not be permitted to continue under IFRS 17, as originally issued.

If the loan transfers significant insurance risk, then it would fall in the scope of IFRS 17. This may cause complexities for lenders that have not applied insurance accounting to the loan component of such contracts before.

3.2.2

ED.8A, BC9–BC12, BC18–BC30

What's the Board proposing?

The Board proposes to amend IFRS 9 and IFRS 17 to allow lenders to apply either standard to loans for which the only insurance cover is for the settlement of some or all of the borrower's obligations under the loan. Lenders would make this choice irrevocably at the portfolio level.

This proposal would reduce IFRS 17 implementation costs for many lenders.

ED.D

Transition

This proposal would introduce specific transition requirements for loans that transfer significant insurance risk if the lender:

– elects to apply IFRS 9 rather than IFRS 17 to these loans; and

– has already adopted IFRS 9 before initially applying IFRS 17.

For these loans, the Board proposes adding:

– requirements for the lender to identify and apply the necessary transition requirements found in IFRS 9;

– transition requirements for designation of financial liabilities as at fair value through profit or loss (FVTPL), similar to the existing transition requirements for financial assets in paragraph C29 of IFRS 17 – specifically, the lender would be:

  - permitted to newly designate a financial liability as at FVTPL to the extent that a new accounting mismatch is created; and

  - required to revoke its designation of a financial liability as at FVTPL to the extent that an accounting mismatch no longer exists;

– an exemption from the requirements in paragraph 28(f) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to:

  - restate comparatives; and

  - disclose the effect on each financial statement line item (including earnings per share); and

– additional transition disclosure requirements.

Which standard to apply?

Optional scope exclusion

The Board has observed that the IFRS 17 model would appropriately reflect the features of loan contracts that transfer significant insurance risk.

However, it has also acknowledged that these contracts are often issued by banks and other financial institutions, rather than insurers. These lenders could benefit from having the option to apply IFRS 9 to these loan contracts. This would:

– facilitate comparison with other loans that they issue; and

– eliminate their IFRS 17 implementation costs for these contracts by aligning the accounting for these instruments to:

- other financial instruments held by the lender; and
- their current internal management model.

In deciding which standard to apply, lenders would have to consider the classification of these contracts under IFRS 9, which could differ from their IAS 39 classification.

For example, these contracts could be required to be measured at FVTPL under IFRS 9 (instead of at amortised cost, as most loans are), because the significant embedded insurance risk may mean that the contractual cash flows are not solely payments of principal and interest.

Transition

If a lender has already adopted IFRS 9 before it initially applies IFRS 17, then it may have applied IFRS 9 (fully or partially) to these contracts and measured them at FVTPL.

These measurements might not change significantly on transition to IFRS 17 if the lender opts to continue accounting for these contracts under IFRS 9. Some of the proposed transition reliefs may then be less relevant – e.g. the exemption from restating comparatives.

4 Insurance acquisition cash flows

The Board's proposal would require insurers to allocate part of the insurance acquisition cash flows that are directly attributable to newly issued contracts to expected contract renewals, meaning that such newly issued contracts are less likely to be onerous.

4.1 Accounting for expected renewals

4.1.1 What's the issue?

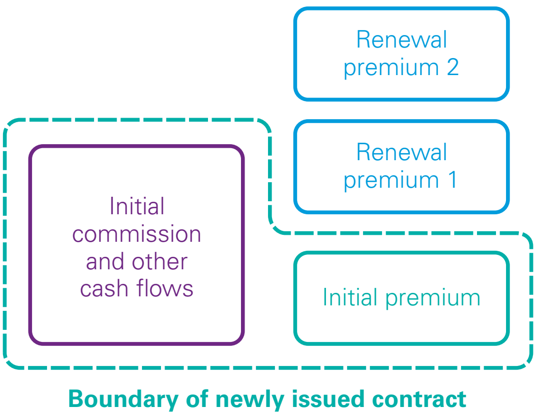
IFRS 17.B65(e)

Under IFRS 17, insurance acquisition cash flows are accounted for by including them in the fulfilment cash flows for the relevant group of insurance contracts. This treatment reduces the contractual service margin (CSM), which results in less profit being recognised over the coverage period of the insurance contracts issued.

Insurance acquisition cash flows may comprise commissions paid for new contracts issued in the expectation that policyholders will renew their coverage in the future, perhaps on several occasions. In some cases, the commissions paid may exceed the margins embedded in the premium for the initial contract that are available to cover such costs, because the insurer expects to recover a portion of the costs from future renewals.

Under current IFRS 17, if the commission is non-refundable, then it is included within the boundary of the newly issued contract regardless of whether future renewals are taken into account when determining the commission to be paid.

If the expected renewal of the contract is outside the boundary of the newly issued contract, then the acquisition cash flows would reduce the contract's profitability in the first period, possibly to the extent that the newly issued contract is onerous under IFRS 17.



4.1.2

ED.28A–28D, B35A–B35C, BC31–BC49

What's the Board proposing?

The Board proposes amending IFRS 17 so that insurers would be required to allocate part of the insurance acquisition cash flows that are directly attributable to a group of newly issued contracts to expected renewals of that group of contracts that are outside the contract boundary.

Consequently, insurance acquisition cash flows allocated to future renewals would be recognised as an asset until the expected contract renewals are recognised. The Board also proposes further amendments to the accounting for assets representing insurance acquisition cash flows paid before the related group of insurance contracts is recognised.

In particular, insurers would:

– assess the recoverability of the asset at each reporting date, basing the assessment on the expected fulfilment cash flows of the related group(s) of contracts (such as expected renewals) yet to be recognised; and

– recognise in profit or loss:

  - any unrecoverable amount as a loss; and

  - any reversal of some or all of this loss if the adverse conditions have improved.

ED.105A–105C

The Board also proposes amending IFRS 17's disclosure requirements to reflect this proposal. Insurers would be required to:

– reconcile the asset created by the insurance acquisition cash flows at the beginning of the reporting period and at the reporting date, and its changes – specifically, any loss for lack of recoverability or reversals recognised; and

– provide quantitative disclosures (in appropriate time bands) about when these cash flows are expected to be included in the measurement of the related insurance contracts.

Allocating insurance acquisition cash flows to future renewals

For many insurers, the concept of deferring insurance acquisition cash flows and assessing the asset for recoverability is a familiar one, similar to current practice under IFRS 4.

However, the expectation of future renewals, the allocation of acquisition costs and the recoverability test that would be required under the Board's proposal may need to be performed at a more granular level than current practice – i.e. at the level of groups of insurance contracts.

Insurers would need to:

- identify and analyse their acquisition costs to determine which ones relate to expected contract renewals outside the contract boundary;
- evaluate their expectations of future contract renewals beyond the current contract boundary;
- allocate acquisition cash flows to those renewals; and
- test for recoverability any acquisition cash flows to be deferred and allocated against future renewals outside the current contract boundary.

Applying this amendment would therefore introduce some more granular and extensive processes and judgements.

Options under the premium allocation approach

IFRS 17.59(a), ED.28A

As long as the coverage period of the affected contracts is one year or less, insurers using the premium allocation approach would have the option to either:

- expense all insurance acquisition cash flows when incurred and avoid operational complexity and judgement; or
- recognise these costs as an asset if it is satisfied that they relate to future renewals and are recoverable.

5 Acquired claims liabilities

The Board is proposing to provide practical relief by amending the transition requirements for claims liabilities acquired by an entity in a business combination or portfolio transfer.

5.1 Additional transition relief

5.1.1 What's the issue?

Under IFRS 17, insurance contract liabilities relating to claims settlement are treated differently depending on whether the insurer:

– issued the contracts; or

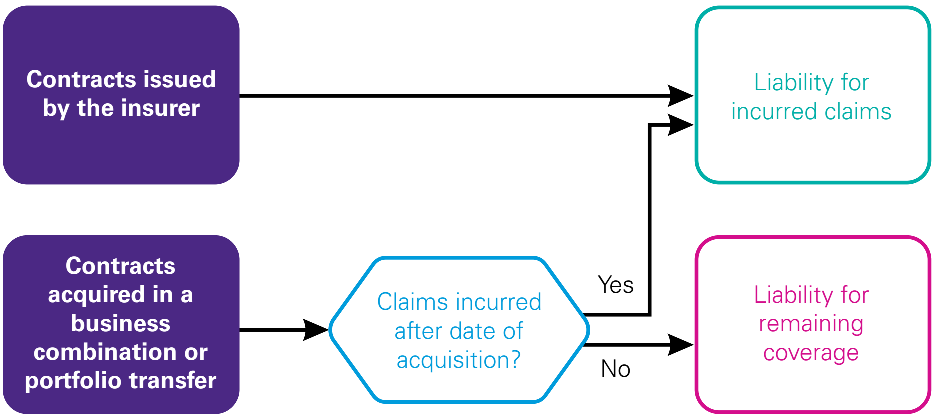
IFRS 17.B93–B95

– acquired them (either in a business combination or in a portfolio transfer: i.e. a transfer of insurance contracts that do not form a business).

IFRS 17.B5

In the latter case, the insurer accounts for any contracts acquired as if the insurer had issued them on the date of acquisition. This means that the insured event for acquired claims liabilities – i.e. a liability for settlement of claims arising before the contract was acquired – determines the ultimate cost of the claims. Therefore, the related coverage period runs from the date of acquisition to when that ultimate cost is determined.

The liabilities are classified as follows.



The requirement to account for acquired claims liabilities as a liability for remaining coverage poses a challenge for some insurers on transition.

This is because some insurers use a single system to manage all claims liabilities. An insurer using such a system may not be able to distinguish between claims liabilities arising from contracts that it issued and those that it acquired. As a result, it may be impracticable to separate and measure claims liabilities in two different ways.

Some stakeholders observed that the modified retrospective approach to transition made no allowance for classifying fulfilment cash flows as liabilities for incurred claims or liabilities for remaining coverage. They also raised similar concerns for the fair value approach to transition.

5.1.2 What's the Board proposing?

ED.C9A, C22A, BC120–BC124

The Board proposes amendments to the transition approaches for claims liabilities acquired by an insurer before the date of transition to IFRS 17, either in a business combination in the scope of IFRS 3 *Business Combinations* or a portfolio transfer.[3]

These would provide practical relief by eliminating the challenge of recording claims liabilities in two different ways – as IFRS 17 currently requires – if the information is not available.

Modified retrospective approach

The Board proposes adding a specified modification to the modified retrospective approach to transition for the treatment of acquired claims liabilities. Under this modification, the insurer would account for these liabilities as a liability for incurred claims.

Consistent with the other modifications, the insurer would be permitted to use the specified modification only to the extent that it does not have reasonable and supportable information to apply a retrospective approach – i.e. to identify the acquired claims liabilities and account for them separately as a liability for remaining coverage.

Fair value approach

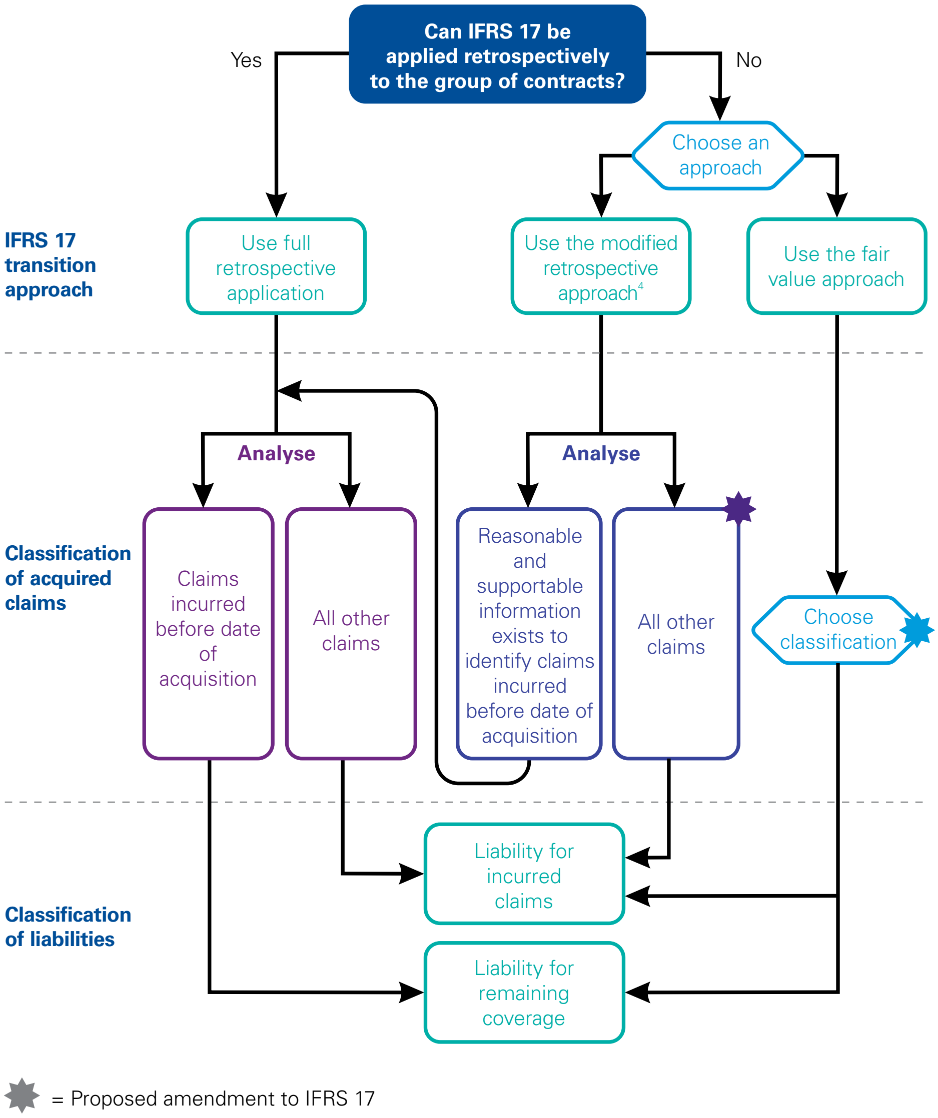
The Board also proposes amending the fair value approach to transition so that an insurer could choose to classify acquired claims liabilities as a liability for incurred claims.

3. The date of transition is generally the beginning of the annual reporting period immediately preceding the date of initial application (see 2.1.1 in this publication and paragraphs C2 and C25 of IFRS 17). If an entity presents adjusted comparative information for any earlier periods, then the date of transition is the beginning of the earliest adjusted comparative period presented.

Applying the proposed amendments

IFRS 17.C5–C8

The following flowchart summarises the accounting for acquired claims liabilities on transition to IFRS 17 under the proposed amendments.



4. If an entity cannot obtain reasonable and supportable information to apply the modified retrospective approach, then it applies the fair value approach. See paragraph C6(a) of IFRS 17.

Practical relief for acquired claims liabilities

The proposed amendments would provide a meaningful practical solution when insurers do not have the necessary information to identify acquired claims liabilities on transition and classify them in accordance with the general requirements. In these cases, all claims liabilities arising from acquired contracts existing on the date of transition would be classified as a liability for incurred claims.

The accounting for a liability for incurred claims uses a less complex measurement approach than a liability for remaining coverage. There would be no need to determine a CSM at transition for acquired claims liabilities, meaning that no insurance revenue would subsequently be recognised in profit or loss.

The proposed amendments would apply only to contracts acquired before the date of transition to IFRS 17. Any contracts acquired after the date of transition would need to be treated as if the acquirer had issued them on the date of acquisition. This means that these acquired claims liabilities would be classified as a liability for remaining coverage going forward.

6 Accounting for investment services

The Board proposes amending the profit recognition pattern for insurance contracts to reflect the provision of insurance coverage and any investment services.

6.1 Proposed changes to profit recognition pattern

6.1.1 What's the issue?

IFRS 17.B119(a)–(c)

The CSM is currently recognised in profit or loss by allocating the balance to coverage units, which are determined by assessing:

- the quantity of benefits provided under the insurance contracts to which it relates; and
- their expected duration.

Under IFRS 17 as originally issued, the quantity of benefits and contract duration relate only to insurance coverage (for both direct participating insurance contracts and all other insurance contracts). Any investment services provided under the contract are not taken into account.

This is an issue because – for insurance contracts that also provide investment services – the CSM recognition period and profit would not reflect all of the services provided under the contract.

6.1.2 What's the Board proposing?

ED.B119A–B119B, ED.BC50–BC66

The Board is proposing to amend the profit recognition pattern for insurance contracts to reflect the provision of both insurance coverage and any investment services.

ED.A

The proposals include a new definition of 'insurance contract services', which includes the following.

Service provided to the policyholder	Description	Applies to…
Insurance coverage	Coverage for an insured event	All insurance contracts
Investment-related service	Managing underlying items on behalf of the policyholder	Direct participating contracts only
Investment return service	Generating an investment return for the policyholder	Insurance contracts that are not direct participating contracts

The definition of 'coverage period' would also be amended to mean the period during which the entity provides insurance contract services. The determination of coverage units would then be aligned with these new definitions.

Direct participating contracts

ED.45

For direct participating contracts, the coverage period and the allocation of coverage units would be determined based on the provision of insurance services and investment-related services.

An investment-related service would exist in all direct participating contracts – i.e. those contracts that meet the criteria to qualify for the variable fee approach.

All other insurance contracts

ED.44

The Board is proposing that the CSM would be allocated based on coverage units that are determined by considering both insurance coverage and any investment return service.

The Board has decided that an investment return service may exist in an insurance contract *only* if both of the following criteria are met.

- There is an investment component or the policyholder has a right to withdraw an amount.
- The investment component, or the amount that the policyholder has a right to withdraw, is expected to include a *positive investment return* that is generated by the *insurer's investment activity*.

A 'positive investment return' could be zero or below in certain circumstances. For example, in a negative interest rate environment where the benchmark yield is below zero, a positive investment return could be below (or equal to) zero as long as it is above the benchmark yield.

Satisfying the above criteria would be necessary – but not sufficient on its own – to demonstrate that an investment return service exists. Further analysis and the exercise of judgement would still be needed to identify an investment return service.

For example, an insurer does not provide an investment return service if it provides only investment custody services for the investment component of an insurance contract. In many cases, insurers would need to use judgement – exercised consistently – in making their assessment of whether investment return services are provided.

Example 2 – Investment return service in an insurance contract with no investment component

Fact pattern

Insurer X issues a deferred annuity contract to a policyholder, who pays the premiums up-front. Under the contract:

- the premiums earn a return during the accumulation phase; and
- the accumulated amount can be converted at a future date into an annuity.

Analysis

After conversion there is no guaranteed payment to the policyholder. For example, if the policyholder dies before the first annuity payment, then the policyholder receives nothing. In this situation, there is no investment component because a scenario exists in which the amount is not repaid.

However, during the accumulation phase it is possible to conclude that an investment return service is being provided if the amount that the policyholder can withdraw includes an investment return that is:

- generated by the insurer's investment activity; and
- expected to be positive.

Disclosure requirements

ED.109, 117

The Board proposes to amend IFRS 17's disclosure requirements, by requiring insurers to provide:

- quantitative disclosures, in appropriate time bands, of the expected recognition in profit or loss of the CSM remaining at the reporting date (IFRS 17 currently permits qualitative disclosures without requiring quantitative disclosures); and
- specific disclosures about their approach to assessing the relative weighting of the benefits provided by insurance coverage and investment-related services or investment return services.

Allocating the CSM to investment return services for contracts under the general measurement model

Identifying investment return services

Under the proposal, insurers would need to assess their insurance contracts to determine whether there is an investment return service, which may affect the coverage period and determination of coverage units.

If there is an investment return service, then an insurer would need to assess on a systematic and rational basis the relative weighting of insurance coverage and the investment return service and their pattern of delivery to determine how the CSM is recognised in profit or loss. These same considerations would be required for investment-related services in direct participating contracts.

This proposal is important because it would affect:

– the timing of profit recognition;

– whether related investment administration costs are included in the fulfilment cash flows; and potentially

– whether insurance contracts qualify for the premium allocation approach.

Including investment-related costs in the fulfilment cash flows could have consequences for insurers' systems and processes as well as profit recognition and financial statement presentation.

Insurers: Act now!

Insurers should start evaluating the implications of these changes now and consider how they can be operationalised, applying a consistent approach to similar products when determining whether an investment return service exists.

Determining the appropriate weighting and recognition of investment return services will be complex and require careful consideration, and the determination of coverage units that reflect the provision of multiple services.

Some insurers may look to take the simplest possible approach – e.g. recognising profit on a straight-line basis, adjusted for changes in the quantity of benefits to reflect:

– the varying sizes of contracts in force; and

– their relative coverage periods.

Given the impact on profit recognition, it would also be advisable for insurers to update financial impact assessments for these proposals, noting that a number of them are inter-related and are influenced by other judgements in these proposals.

7 Reinsurance of onerous contracts

The Board's proposal would address accounting mismatches that arise on initial recognition when an insurer reinsures onerous contracts.

7.1 Addressing accounting mismatches

7.1.1 What's the issue?

IFRS 17.48, 66(c)(ii), BC314–BC315

When measuring onerous insurance contracts *after* their initial recognition, any unfavourable changes in fulfilment cash flows relating to future services are recognised in profit or loss.

If these unfavourable changes are covered by reinsurance contracts held that are measured using the general measurement model, then any resulting changes in the fulfilment cash flows of the reinsurance contracts held are also recognised in profit or loss – i.e. they do not adjust the CSM of the group of reinsurance contracts held. This reduces accounting mismatches that would arise otherwise.

IFRS 17.47, 66(c)(i)

IFRS 17 as originally issued requires an insurer to recognise losses in profit or loss when it issues onerous insurance contracts. However, no corresponding gains are recognised in profit or loss at the same time if the losses are covered by reinsurance contracts held. This can result in an accounting mismatch.

7.1.2 What's the Board proposing?

ED.62, 70A, BC67–BC90

The Board proposes amendments to IFRS 17 to address the accounting mismatch that would otherwise arise when reinsurance contracts held provide *proportionate* coverage against the losses of underlying insurance contracts that are onerous on initial recognition.

Proportionate reinsurance contracts

ED.A

The Board proposes to define a reinsurance contract held that provides proportionate coverage (i.e. a proportionate reinsurance contract) as a reinsurance contract held that provides the insurer with the right to recover from the issuer a percentage of all claims incurred on groups of underlying insurance contracts. The percentage that the entity has a right to recover is fixed for all contracts in a single group of underlying insurance contracts but can differ between groups of underlying insurance contracts.

The Board decided to propose an amendment only for proportionate reinsurance contracts. This is because the mismatch between the timing of the recognition of claims and the recognition of recoveries can be directly identified for proportionate reinsurance contracts.

Applying the proposals

ED.66A–66B, B119C–B119F

To the extent that a group of reinsurance contracts held provides *proportionate* coverage, an insurer that recognises losses on onerous underlying contracts would be required, on their initial recognition, to:

- recognise a gain on the reinsurance contracts held in profit or loss at the same time; and
- reverse the gain on the reinsurance contracts held in profit or loss when it subsequently reverses the losses on the onerous underlying contracts.

An insurer would be required to establish a loss recovery component of the asset for remaining coverage for a group of reinsurance contracts held when applying the amendments as described above.

This loss recovery component would determine the amounts that would be presented in profit or loss as reversals of recoveries of losses from reinsurance contracts held. These amounts would be excluded from the allocation of premiums paid to the reinsurer.

The gain on the reinsurance contracts held (and its reversal) would adjust:

- the CSM of the group of reinsurance contracts held if it is measured using the general measurement model; or
- the carrying amount of the asset for remaining coverage of the group of reinsurance contracts held if it is measured using the premium allocation approach.

These amendments would apply only to reinsurance contracts entered into before, or at the same time as, the onerous underlying contracts are issued.

Example 3 – Reinsurance of onerous contracts

Fact pattern

On 1 January 2022, Insurer X issues a group of insurance contracts with a coverage period of two years.

- X receives total premiums of 200 immediately following initial recognition.
- X expects to pay claims of 180 evenly over the coverage period and incurs insurance acquisition cash flows of 40.

IFRS 17.61–62(a)

At the same time, X enters into a reinsurance contract that provides 50% proportionate coverage for claims arising from the underlying contracts.

X identifies a group comprising the single reinsurance contract held and recognises this group on 1 January 2022. The single reinsurance premium paid on initial recognition is 100. X expects future cash inflows of 90 (i.e. 50% of expected claims on the underlying contracts).

For simplicity, the effects of discounting, the risk adjustment for non-financial risk and the risk of non-performance of the reinsurer are negligible.

X measures the group of underlying contracts on initial recognition as follows.

1 January 2022	Onerous group
Estimates of present value of cash inflows – i.e. premiums	200
Estimates of present value of cash outflows – i.e. claims (180) and insurance acquisition cash flows (40)	(220)
Loss component	**(20)**

All events occur during the coverage period as expected on initial recognition. At 31 December 2022, X measures the groups of underlying contracts as follows.

31 December 2022	
Fulfilment cash flows	90[1]
CSM	-
Insurance contract liability	**90**

Note

1. Representing claims of 90.

IFRS 17.63–65, ED.65–66B

Reinsurance contract held – Initial measurement

The following table compares how X would initially measure the reinsurance contract held under current IFRS 17 requirements and under the proposed amendments.

1 January 2022	IFRS 17 as originally issued	IFRS 17 with proposed amendments
Estimates of present value of cash outflows – i.e. reinsurance premiums	100	100
Estimates of present value of cash inflows – i.e. claims recovery	(90)[1]	(90)[1]
Gain recognised in profit or loss	-	10[2]
CSM	**10**	**20**

Notes

1. Being 50% of the expected claims of 180 arising from the underlying contracts.
2. Being 50% of the loss component of 20 for the onerous group of underlying contracts. Under the proposed amendments, this amount would be recognised as a gain in profit or loss and would adjust the initial CSM of the reinsurance contract held.

IFRS 17.66, ED.66–66B

Reinsurance contract held – Subsequent measurement

X would measure the reinsurance contract held at 31 December 2022 as follows.

31 December 2022	IFRS 17 as originally issued	IFRS 17 with proposed amendments
Fulfilment cash flows	45	45
CSM	5[1]	10[2]
Reinsurance contract asset	**50**	**55**

Notes

1. Being the beginning CSM of 10 minus CSM release of 5 in the year 2021.
2. Being the beginning CSM of 20 minus CSM release of 10 in the year 2021.

Insurance service result

X would calculate the insurance service results for 2022 and 2023 as follows.

	IFRS 17 as originally issued		IFRS 17 with proposed amendments	
	2022	2023	2022	2023
Insurance revenue	100[1]	100[1]	100[1]	100[1]
Insurance service expenses	(120)[2]	(100)[3]	(120)[2]	(100)[3]
Insurance contracts issued total	**(20)**	**-**	**(20)**	**-**
Reinsurance premiums	(50)[4]	(50)[4]	(50)[5]	(50)[5]
Amounts recovered from reinsurance	45[6]	45[6]	50[7]	40[8]
Reinsurance contract held total	**(5)**	**(5)**	**-**	**(10)**
Insurance service result	**(25)**	**(5)**	**(20)**	**(10)**

IFRS 17.B124

Notes

1. Being expected incurred claims of 90 plus allocated insurance acquisition cash flows of 20 minus reversal of the loss component of 10.
2. Being actual claims incurred of 90 plus the loss component recognised on initial recognition of 20 and insurance acquisition cash flows of 20, minus reversal of the loss component of 10.
3. Being actual claims incurred of 90 plus insurance acquisition cash flows of 20 minus reversal of the loss component of 10.
4. Being expected claims of 45 plus CSM release of 5.
5. Being expected claims of 45 plus CSM release of 10 minus reversal of half of the loss recovery component of 5 applying the amendment.

IFRS 17.B123

6. Being claims reimbursed of 45 (50% of 90).
7. Being claims reimbursed of 45 plus the gain recognised in profit or loss on initial recognition of 10 (i.e. the initial loss recovery component) minus release of half of the loss recovery component of 5.
8. Being claims reimbursed of 45 minus release of half of the loss recovery component of 5.

Applying the proposed amendment

As shown in the example above, the proposed amendment would apply in cases where it may appear that the loss recognised in the statement of profit or loss on the underlying contracts is a result of insurance acquisition cash flows as opposed to expected claims. However, the Board considers that it would be reasonable to assume that the loss arises from expected claims cash flows and that there is a direct link between those claims and expected recoveries under the reinsurance contract.

Further, the amendment would apply even if there is a net cost (and not a net gain) from the reinsurance contract held. This is because the amendment is intended to address only the mismatch between the recognition of the loss on the underlying contract – that is assumed to result from expected claims – and the recognition of the associated recovery under the reinsurance contract.

The net cost of the reinsurance contract would continue to be recognised in profit or loss over the coverage period of the reinsurance contract held. The effect of applying the proposed amendment would be to increase the net cost that is recognised over the contractual service period (i.e. the net cost that is recognised over the contractual service period would increase by the amount of the gain recognised on initial recognition of the onerous underlying contract).

These proposed amendments aim to provide better information about the economic effects of reinsurance contracts held by reducing an accounting mismatch and, as a result, reduce complexity for users of financial statements.

Proportionate vs proportional reinsurance contracts

The proposed amendment provides a definition of proportionate reinsurance. Insurers would need to work out how to identify whether reinsurance contracts held provide proportionate coverage to the groups of insurance contracts that they cover as they develop their systems and processes to account for these contracts.

This proposed definition differs from what is commonly known as *proportional* reinsurance. In a proportional reinsurance arrangement, the reinsurer accepts a fixed proportion of each risk, in exchange for the same proportion of the premium (less commission). In turn, the reinsurer pays the same proportion of any losses.

IFRS 17.62(a)

The scope of this amendment would not apply to excess of loss (even if on an individual risk basis) and surplus treaties if they do not provide proportionate coverage. This is because, although it is possible to identify that the loss is being caused by claims incurred, it is not possible to identify exactly which claims are giving rise to the recovery. This new definition would also narrow the scope of the specific approach that is used for initial recognition of a group of proportionate reinsurance contracts held.

The way that the underlying contracts are grouped would also influence whether the proposed relief could be applied. The amendment would apply only if all contracts in the underlying group are covered by the reinsurance and in the same fixed proportion.

Other considerations

When determining whether a group of insurance contracts is onerous on initial recognition, an insurer would consider whether:

- the effect of reinsurance would be reflected in the risk adjustment for non-financial risk (assuming that the insurer entity considers reinsurance when determining the compensation that it requires for bearing non-financial risk related to the underlying insurance contracts); and
- the proposed amendments for allocating insurance acquisition cash flows to future renewals would apply.

Insurers will need to continue developing new systems and processes to account for these contracts under IFRS 17 and consider the impacts on reinsurance programmes. They will have to consider how these activities could be impacted by the proposed amendments for reinsurance accounting.

8 Risk mitigation for direct participating contracts

The Board's proposal aims to reduce accounting mismatches by amending the accounting for direct participating contracts when reinsurance contracts held are used to mitigate financial risk and on transition to IFRS 17.

8.1 Using reinsurance contracts held

8.1.1 What's the issue?

IFRS 17.B115–B118

An insurer may use derivatives to mitigate the financial risks arising from the direct participating contracts that it issues – this could give rise to an accounting mismatch.

This is because the change in the derivatives' fair value is recognised immediately in profit or loss under IFRS 9. Conversely – under the variable fee approach – the related change in the value of the insurance contracts is generally accounted for by adjusting the CSM rather than being recognised immediately in profit or loss (provided that the derivative is not an underlying item).

To avoid this accounting mismatch, IFRS 17 permits an insurer to use the risk mitigation option. This option allows an insurer to recognise the effect of related changes in financial risk on its insurance contracts in profit or loss instead of by adjusting the CSM.

The risk mitigation option may be used if all of the following criteria are met.

– The insurer applies a previously documented risk management objective and strategy for using derivatives to mitigate financial risk arising from the insurance contracts.

– The insurer uses a derivative to mitigate financial risks arising from the insurance contracts – e.g. the effect of financial guarantees.

– An economic offset exists between the insurance contracts and the derivative.

– Credit risk does not dominate the economic offset.

Some reinsurance contracts held are structured in a way that enables the cedant to mitigate financial risks arising from its underlying contracts. An accounting mismatch, similar to that described above, may arise when the underlying contracts are accounted for under the variable fee approach.

This is because reinsurance contracts held and issued are not direct participating contracts, so they are not eligible for the variable fee approach. The change in the financial risks of underlying direct participating contracts adjusts the CSM of those contracts; however, any changes in the financial risk of reinsurance contracts held are recognised in profit or loss (or OCI).

Under current IFRS 17, the risk mitigation option that is available to reduce mismatches like these is available only when an insurer uses derivatives to mitigate financial risk and cannot be applied to reinsurance contracts held for this purpose.

8.1.2 What's the Board proposing?

ED.B116, BC101–BC109

The Board proposes to expand the risk mitigation option for direct participating insurance contracts so that it may be applied when an insurer uses a reinsurance contract held to mitigate financial risk.

This means that insurers would be permitted to recognise changes in financial risk in profit or loss when *either a derivative or a reinsurance contract held* is used for risk mitigation purposes, provided that the same criteria above are met.

The proposed expanded risk mitigation option could reduce accounting mismatches that arise when reinsurance contracts held that are not underlying items are used to mitigate the financial risks of direct participating contracts.

This amendment would allow insurers to better reflect their risk mitigation activities in their financial reporting regardless of whether they have used derivatives or reinsurance contracts to mitigate financial risk.

The Board confirmed that reinsurance contracts held are not eligible for the variable fee approach, even if the underlying contracts are direct participating contracts. The Board's rationale is that it designed the variable fee approach for contracts that are substantially investment-related service contracts. Reinsurance contracts provide insurance coverage and do not substantially provide investment-related services.

Reinsurance contracts held that are underlying items of direct participating contracts

In practice, some reinsurance contracts held are underlying items of the direct participating contracts. In these circumstances, risk mitigation is automatically captured when applying the variable fee approach.

If insurers are using instruments other than derivatives or reinsurance contracts held to mitigate financial risk, then other solutions may need to be determined to reduce accounting mismatches – e.g. classifying financial instruments as at amortised cost if they qualify.

8.2 Transition requirements

8.2.1 What's the issue?

The risk mitigation option permits insurers to recognise the effect of some changes in financial risk for direct participating contracts in profit or loss rather than by adjusting the CSM – subject to certain criteria as described in 8.1.1.

The option cannot be applied in periods before the date of initial application of IFRS 17 (i.e. the beginning of the annual reporting period in which the insurer first applies IFRS 17) because it could involve the use of hindsight.

If risk mitigation activities were in place before the date of initial application of IFRS 17, then this prohibition may distort equity on transition and revenue recognised in future periods.

This results from differences in accounting treatment between insurance contracts and related risk mitigation activities on transition to IFRS 17.

8.2.2 What's the Board proposing?

Applying the risk mitigation option prospectively

IFRS 17.C2, C25, ED.C3, BC125–BC133

The Board proposes permitting an insurer to apply the risk mitigation option prospectively from the date of transition to IFRS 17 – i.e.:

– the beginning of the annual reporting period immediately before the date of initial application; or

– if adjusted comparative information is presented for any earlier periods, the beginning of the earliest such period.

This is permitted provided that the insurer designates the risk mitigation relationships to which it will apply the risk mitigation option no later than the date of transition to IFRS 17.

Using the fair value approach to transition

ED.C5(b), BC125–BC133

The Board also proposes to permit an insurer to use the fair value approach to transition for a group of direct participating insurance contracts (even if it can apply a full retrospective approach), if both of the following conditions are met.

– The entity chooses to apply the risk mitigation option to the group of insurance contracts prospectively from the date of transition.

– The entity has used derivatives or reinsurance contracts held to mitigate financial risk arising from the group of insurance contracts before the date of transition.

If an insurer uses the fair value transition option in this way, then it would measure groups of insurance contracts using current estimates of financial assumptions. Any derivatives or reinsurance contracts held would be measured at fair value, meaning that equity on transition would reflect both:

– previous changes in fulfilment cash flows due to changes in financial assumptions; and

– changes in the fair value of the derivatives providing risk mitigation.

Careful consideration would be needed to apply the transition requirements

To apply the risk mitigation option prospectively from the date of transition to IFRS 17, insurers will need to plan ahead. Next steps include designating, implementing and appropriately documenting the risk mitigation relationships to which they wish to apply this amendment.

The availability of the fair value transition approach in these circumstances would address some key preparer concerns.

Others have commented that although this would address some aspects of financial risk mitigation on transition, it does not address other steps taken to mitigate financial and non-financial risks on transition. An example is when reinsurance contracts held are used to mitigate the risk of changes in non-financial assumptions – e.g. changes in demographic assumptions – that would still be reflected in the CSM.

Insurers should consider voluntary disclosures that would explain the effect of non-financial assumptions and related risk mitigation activities.

Insurers should carefully consider these proposed amendments to the transition requirements – assessing which approach would be best suited to their business and risk appetite, and would provide users with the most useful information.

9 Presentation of insurance contract assets and liabilities

The Board's proposal would require insurance contracts to be presented in the statement of financial position at the portfolio level – a higher level than currently required.

9.1 Presentation at portfolio level

9.1.1 What's the issue?

IFRS 17.78–79, BC328, IAS 1.54

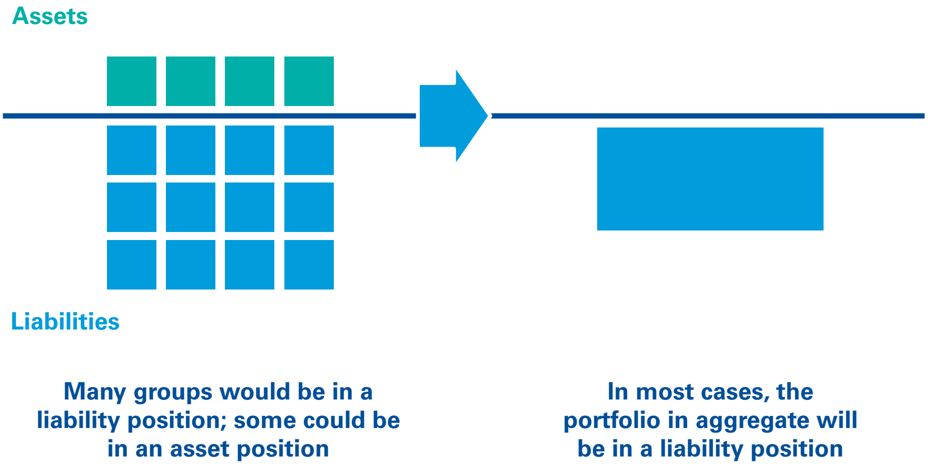
IFRS 17 currently requires insurers to present separately groups of insurance contracts issued that are assets and those that are liabilities. Groups of reinsurance contracts held are required to be presented in the same way. Groups that are assets cannot be offset against groups that are liabilities in the statement of financial position.

IFRS 17.16–24

A group of insurance contracts is a lower level of aggregation than a portfolio of insurance contracts. IFRS 17 requires an insurer to divide portfolios – which are insurance contracts that are subject to similar risks and managed together – into groups based on their profitability and dates of initial recognition, such that groups generally comprise similar contracts issued within a period of one year or less.

Although groups of contracts may switch between asset and liability positions over time depending on the timing of cash receipts and payments, portfolios of contracts issued are generally expected to be in a liability position consistently.

Portfolio comprising groups of insurance contracts issued



Allocating premium cash flows due and the liability for incurred claims to the carrying amounts of individual groups of insurance contracts can be challenging for some insurers, depending on the design of their systems.

9.1.2 What's the Board proposing?

ED.78–79, 99, 132, BC91–BC100

The Board proposes amending IFRS 17's presentation requirements so that the carrying amounts of insurance contract assets and insurance contract liabilities would be presented in the statement of financial position reflecting aggregation at a portfolio level, rather than group level.

Consequently, offsetting – for presentation purposes – would effectively be applied between groups of insurance contracts in the same portfolio. The higher level of aggregation would also apply to reconciliation and maturity analysis disclosures.

This would provide practical relief to insurers that may find it difficult to allocate cash flows to individual groups of insurance contracts.

Presenting insurance contracts at portfolio level

In making this proposal, the Board made the following observations. The loss of information caused by offsetting groups in the statement of financial position could be seen as acceptable when balanced against the significant practical relief.

Although the proposed amendment is likely to provide practical relief for insurers, some may still encounter challenges when it comes to data. For example, because reinsurance deposits are often held by cedants, some reinsurers' portfolios may be in an asset position, with others in a liability position. An allocation of cash flows expected from deposits between these portfolios would be required.

Other challenges that remain include allocating cash flows that are settled on a net basis to the liability for remaining coverage and the liability for incurred claims. This is particularly common in reinsurance agreements and if insurance or reinsurance contracts are intermediated by brokers.

IFRS 17.121–132, IAS 1.55

IFRS 17's balance sheet presentation is based on expected cash flows, and does not distinguish future cash flows due from those not yet due. This is a big change from what stakeholders are used to seeing today. Insurers may wish to disaggregate required line items to show additional information if this presentation would aid financial statement users' understanding of their financial position.

In addition, the disclosure requirements of IFRS 17 will provide users with additional useful information about the risks related to insurance contracts as compared with current practice. Preparers will need to identify the needs of financial statement users to provide meaningful presentation and disclosures.

About this publication

This publication has been produced by the KPMG International Standards Group (part of KPMG IFRG Limited).

This edition considers the proposed amendments to IFRS 17 *Insurance Contracts* published by the International Accounting Standards Board in its June 2019 exposure draft ED/2019/4 *Amendments to IFRS 17*.

The text of this publication refers to IFRS 17 and to selected other current standards in issue at 12 July 2019.

Further analysis and interpretation will be needed for a company to consider the impact of the amendments to IFRS 17 in light of its own facts, circumstances and individual transactions. The information contained in this publication is based on initial observations developed by the KPMG International Standards Group and these observations may change. Accordingly, neither this publication nor any of our other publications should be used as a substitute for referring to the standards and interpretations themselves.

Acknowledgements

We would like to acknowledge the efforts of the following members of the KPMG International Standards Group, who were the principal authors of this publication: Albert Chai, Alana Hudson, Hagit Keren and Lindsey Stewart.

We would also like to thank the members of KPMG's global IFRS insurance contracts topic team for their contribution:

Jennifer Austin	US
Erik Bleekrode	Hong Kong
Dana Chaput	Canada
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Danny Clark	UK
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Viviane Leflaive	France
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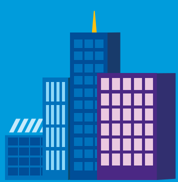

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Publication name: *Insurance Contracts – New on the Horizon: Amendments to IFRS 17*

Publication number: 136566

Publication date: July 2019