IFRS 17 – Background to the standard

Details of the discussions that led to amendments

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Overview

In the years following its initial publication in May 2017, IFRS 17 *Insurance Contracts* was the subject of much discussion, deliberation and change. The International Accounting Standards Board (the IASB) monitored and supported discussions and made amendments in eight key areas, culminating in the publication of an exposure draft of amendments to IFRS 17 in June 2019, and ultimately the revised requirements in June 2020.

Throughout this process, KPMG kept readers apprised of developments. Even in 2024, there is sustained interest in the considerations that led to each of these amendments. We have therefore consolidated our analysis on the eight areas discussed during this period, into a single easy-to-use document.

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Identifying the insurance contract

Assessing what is accounted for under IFRS 17 and what components of a contract are separated.

Scope of IFRS17 – Credit cards and similar products that provide insurance coverage

International Accounting Standards Board meetings, January 2020 and March 2019

What's the issue?

Some contracts – such as credit cards or other similar contracts that provide credit or payment arrangements – may provide insurance coverage and transfer significant insurance risk.

For example, consider a credit card where the card issuer provides insurance coverage for purchases made by the customer using the credit card, under which the card issuer would pay the customer for claims resulting from the suppliers' misrepresentations or breaches of contract. Under this arrangement, the card issuer may:

- charge no fee to the customer;
- charge an annual fee that does not reflect an assessment of the insurance risk associated with that individual customer; or
- charge a fee that reflects the insurance risk associated with each individual customer.

The credit card contract contains both insurance and non-insurance components. This could become a challenge for financial statement preparers because the requirements in IFRS 17 for separating non-insurance components differ from those in the current insurance contracts standard, IFRS 4 *Insurance Contracts*, as explained in the table below.

Stakeholders are concerned that, when IFRS 17 becomes effective, card issuers currently accounting for a loan (or a loan commitment) in a credit card contract under IFRS 9 *Financial Instruments* or other IFRS® Accounting Standards would need to change the accounting for those contracts that transfer significant insurance risk. This accounting change would need to take place only a short time after incurring costs to develop a new credit impairment model to comply with IFRS 9.

IFRS 4	IFRS 17
Permits an insurer to separate a loan component from an insurance contract and apply IFRS 9 or other IFRS Accounting Standards to the loan component.	Generally requires IFRS 17 to be applied to the whole contract that transfers significant insurance risk. Circumstances under which separation is permitted are narrow compared with IFRS 4.

What did the IASB decide?

At its meeting in January 2020 – in response to feedback on the exposure draft – the Board made the following two decisions on its proposed amendment for credit card contracts.

Credit card contracts	An entity is required to exclude from the scope of IFRS 17 credit card contracts that meet the definition of an insurance contract if, and only if, the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer. If the entity provides the insurance coverage to the customer as part of the contractual terms of such a credit card contract, then the entity is required to:

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<table>
<tr><td></td><td>separate that insurance coverage component and apply IFRS 17 to it; and
apply other applicable IFRS Accounting Standards, such as IFRS 9, to the other components of the credit card contract.</td></tr>
<tr><td>Other similar products</td><td>The IASB also decided to extend the scope of the amendment to other contracts that provide credit or payment arrangements that are similar to such credit card contracts – e.g. debit cards, point of sale cards or similar digital arrangements – if:
those similar contracts meet the definition of an insurance contract; and
the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.
The IASB settled on this scope extension as it believes that these similar arrangements transfer significant insurance risk.</td></tr>
</table>

What's the impact?

If insurance coverage is included in the contract but the pricing does not reflect an assessment of the insurance risk associated with the individual customer, the entity will be required to apply IFRS 17 only to the insurance coverage component and apply other applicable IFRS Accounting Standards, such as IFRS 9, to the other components of the credit card or similar contract.

A card issuer issuing a credit card contract or similar product that provides insurance coverage – but which would be partially excluded from the scope of IFRS 17 under this revised proposed amendment – would need to assess which accounting standard(s) might apply to the different non-insurance components of the arrangement. For example:

- a loan or loan commitment and interest charged could fall under IFRS 9;
- revenue for supplying goods and other services provided by the card issuer might fall under IFRS 15 *Revenue from Contracts with Customers*; or
- IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* may apply to a contract if it becomes onerous and is either in the scope of IFRS 15 or not covered by another accounting standard.

The IASB's objective – that entities issuing credit cards or similar arrangements with bundled insurance should apply IFRS 17 only to the insurance coverage component – will reduce the burden and accounting change from adopting IFRS 17 for banks that apply IFRS 9 to these products.

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Accounting for any investment component within an insurance contract

International Accounting Standards Board meetings, May and April 2019; TRG meeting, April 2019

What's the issue?

Under IFRS 17, insurers are required to identify any investment component within an insurance contract. This raises several questions about how an insurer:

- determines whether an investment component exists;
- assesses whether the investment component is distinct – i.e. separated from the insurance component of the contract for measurement purposes; and
- determines the amount of a non-distinct investment component to be excluded from insurance revenue and insurance service expenses.

The points raised in the TRG's discussion are likely to help insurers implement IFRS 17's requirements in this area.

What did the TRG discuss?

Determining whether an investment component exists

TRG members observed that an insurance contract contains an investment component if an entity is required to repay an amount to the policyholder in all circumstances, including when the contract matures, is terminated or when an insured event occurs. While most TRG members supported clarifying the definition of an investment component along these lines, a few TRG members believed that such clarification is not needed.

Determining the existence of investment components is important because:

- a distinct investment component is separately accounted for under IFRS 9;
- non-distinct investment components are excluded from insurance revenue and insurance service expenses in profit or loss; and
- an investment component is a necessary condition for the existence of an investment-return service, which may impact the determination of coverage units and a company's revenue recognition pattern (see proposed amendments in January 2019).

TRG members observed that insurers would need to take all of the following steps.

- Assess at contract inception whether an investment component exists to identify components to be separated and whether a contract provides investment-return services.
- Assess whether scenarios in which no payments are made have no commercial substance (because these scenarios are ignored when determining whether an investment component exists).
- Understand that the amount of a payment could be zero and assess whether this indicates that there is no investment component. For example, a contract may still contain an investment component if:
    - the policyholder nets a payment due from the insurer against an amount they owe to the insurer; or
    - the account value of a unit-linked contract has reduced to zero because of negative investment returns when it is due to be paid to the policyholder.

Assessing whether an investment component is distinct

TRG members noted that an investment component is distinct only if:

- the investment component and the insurance component are not highly inter-related; and
- a contract providing investment services with equivalent terms is (or could be) sold separately in

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the same market or jurisdiction, either by an insurer or another party.

They observed that the components could be highly inter-related if:

- the value of one component varies with the value of the other component; or
- the policyholder is unable to benefit from one component unless the other is also present – e.g. the maturity or lapse of one component causes the other component to also mature or lapse, or a contractual term prevents the policyholder from cancelling one or both of the components.

As regards available investment services with equivalent terms, TRG members observed that:

- a service would need to reflect all of the terms of the investment component within the insurance contract to be considered equivalent; and
- an investment component within an insurance contract for which the payment timing depends on the death of the policyholder would probably not be available in the market.

TRG members observed that these criteria result in a high hurdle to separate investment components.

Determining the amount of a non-distinct investment component

TRG members observed that there are three types of payments to policyholders under IFRS 17.

Type of payment	Accounting treatment in profit or loss
Incurred claims	Recognised as insurance service expenses
Investment components	Excluded from insurance revenue and insurance service expenses because they do not relate to the provision of insurance services
Premium refunds – e.g. return of premium for insurance services not rendered when a policyholder cancels their policy	These reduce insurance revenue

TRG members observed that an insurer needs to determine the amount of a non-distinct investment component – i.e. an investment component not separated from the insurance component and therefore not separately accounted for under IFRS 9 – to exclude it from insurance revenue and incurred claims only when the latter are recognised.

TRG members noted that IFRS 17 does not specify how to determine the amount of a non-distinct investment component so there are different ways to do so. The determination may be more straightforward when there is an explicit investment component specified in the contract (e.g. an explicit surrender value). In other cases, it may be more challenging to determine the investment component. TRG members observed that one appropriate approach would be to employ a present value calculation.

What did the IASB decide?

The IASB tentatively decided to amend the definition of an investment component as 'the amounts that an insurance contract requires the entity to repay to a policyholder in all circumstances'.

The IASB observed that the clarification is important because the questions received by the TRG indicates that there is confusion and hence the possibility of diversity in practice over the existence of investment components.

What's the impact?

It is important for insurers to carefully assess whether their contracts include investment components given the impact of this assessment on insurance revenue.

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Concerns have been raised about how to differentiate investment components and premium refunds. Although the treatment may be identical for the balance sheet, profit or loss and the contractual service margin, there are specific separation and disclosure requirements that apply only to investment components.

Insurers' concerns about the potential complexity of distinguishing premium refunds and investment components would be alleviated by the IASB's proposed amendment to clarify that, when reconciling opening and closing balances of insurance contract liabilities, insurers are not required to separately disclose premium refunds. However, within that reconciliation, insurers may disclose premium refunds either:

- separately; or
- together with either investment components or premiums received.

Overall, it is important that insurers apply a robust approach that is consistent with the standard in identifying and determining the amount of investment components. This will require careful consideration of the terms of the contractual arrangements.

Scope of IFRS 17 – Credit cards that provide insurance coverage

International Accounting Standards Board meeting, March 2019

What's the issue?

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

For example, consider a credit card where the card issuer provides insurance coverage for purchases made by the customer using the credit card, under which the card issuer would pay the customer for claims resulting from the supplier's misrepresentation or breach of contract. Under this arrangement the card issuer either:

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

The credit card contract contains both insurance and non-insurance components. This could become a challenge for financial statement preparers because the requirements in IFRS 17 for separating non-insurance components differ from those in the current insurance contracts standard, IFRS 4, as explained in the table below.

IFRS 4	IFRS 17
Permits an insurer to separate a loan component from an insurance contract and apply IFRS 9 to the loan component.	Generally requires IFRS 17 to be applied to the whole contract that transfers significant insurance risk. Separation is only permitted in more narrow circumstances compared with IFRS 4.

Stakeholders are concerned that card issuers that currently account for a loan or a loan commitment in a credit card contract under IFRS 9 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.

What did the IASB decide?

The IASB tentatively decided to amend IFRS 17 to exclude certain credit card contracts that provide insurance coverage from the scope of IFRS 17. A credit card contract would be eligible for the exclusion if

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the contract price set by the card issuer for a customer does not reflect an assessment of the insurance risk associated with that individual customer.

What's the impact?

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

- a loan or loan commitment and interest charged could fall under IFRS 9;
- revenue for supplying goods and other services provided by the card issuer might fall under IFRS 15; or
- IAS 37 may apply to a contract if it becomes onerous and is either in the scope of IFRS 15 or not covered by another accounting standard.

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.)

The staff highlighted some of the different features of credit cards that might not be covered by the exemption, but might otherwise be outside the scope of IFRS 17. For example:

- the card issuer merely acts as an agent in selling insurance provided by a third-party insurer;
- the insurance coverage meets the specified conditions for a fixed-fee service contract in paragraph 8 of IFRS 17 and would therefore be accounted for under IFRS 15;
- the insurance coverage provides for the settlement of the customer's obligation created by the contract, such as a waiver of the loan balance of the credit card if the customer dies, and is captured by the scope exclusion for loans that was tentatively agreed in February 2019; and
- certain 'chargeback' mechanisms, which enable the card issuer to process claims from card holders requesting a refund of actual amounts paid using the credit card in respect of non-delivered goods or services.

Scope of IFRS 17 – Loans that transfer significant insurance risk

International Accounting Standards Board meetings, March and February 2019; TRG meeting, September 2018

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 death waiver, some student loans and lifetime mortgages (also known as equity release or reverse mortgages).

IFRS 17 does not include specific requirements with respect to separating a loan that includes an insurance component. Therefore, if the loan transfers significant insurance risk, then it would fall wholly in the scope of IFRS 17.

Currently under IFRS 4, some lenders account for these contracts by separating a loan component from the insurance contract, then applying financial instruments accounting to the loan component (either under IFRS 9 or IAS 39 *Financial Instruments: Recognition and Measurement*).

This practice would not be permitted to continue under IFRS 17, as currently drafted.

What did the TRG discuss in September 2018?

TRG members observed that if these loan contracts fall in the scope of IFRS 17, then the entire contract may need to be accounted for under IFRS 17, in the absence of a specific requirement that allows the lender to separate the loan and the insurance components.

TRG members noted that applying the requirements of IFRS 17 to the entire contract may cause

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complexities for lenders that have not applied insurance accounting to the loan component of such contracts before. Some stakeholders are concerned that applying IFRS 17 to these loans in their entirety would impose costs on lenders without any corresponding benefits.

What did the IASB decide in February 2019?

The IASB proposes amending IFRS 17 and IFRS 9 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.

What did the IASB decide in March 2019?

The IASB observed that its February 2019 decision would require 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 IASB tentatively decided to propose that lenders be required to apply the necessary transition requirements found in IFRS 9. It also proposed providing:

- reliefs related to designation and de-designation of financial liabilities as at fair value through profit or loss (FVTPL); and
- an exemption from:
- restating comparatives; and
- disclosing the effect on each financial statement line item (including earnings per share) under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

However, lenders would still be required to make additional disclosures about transition.

What's the impact?

The IASB has observed that the IFRS 17 model would appropriately reflect these contracts' features. 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 impact that these contracts' classifications would have under IFRS 9, as these could differ from their IAS 39 classifications.

For example, these contracts could be mandatorily 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'.

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. In this case, some of the proposed transition reliefs may be less relevant – e.g. the exemption from restating comparatives.

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Combining multiple insurance contracts

TRG meeting, May 2018

What's the issue?

Insurers sometimes simultaneously issue different contracts to the same policyholder. For example, an insurer may issue two contracts – one for home insurance and one for motor insurance – to the same policyholder at the same time, with the policyholder receiving a discount for the whole transaction.

This raises a question as to when it is necessary to treat multiple insurance contracts as a single contract under IFRS 17.

What did the TRG discuss?

TRG members appeared to agree that an insurance arrangement with the legal form of a single contract would generally also be considered to be a single contract in substance.

IFRS 17 acknowledges that if multiple insurance contracts with the same (or a related) counterparty achieve – or are designed to achieve – an overall commercial effect, then they may reflect a single contract in substance.

TRG members observed that any decision to combine multiple insurance contracts is based on significant judgement considering all relevant facts and circumstances. No single factor is determinative.

They also observed that:

- if the lapse or maturity of one contract causes the lapse or maturity of another, then this may indicate that the contracts were designed to achieve an overall commercial effect; and
- the fact that multiple insurance contracts are entered into at the same time with the same counterparty, or the existence of a discount if a policyholder purchases more than one insurance coverage does not necessarily mean that multiple insurance contracts achieve an overall commercial effect.

It was also noted that allocating any discounts or cross-subsidies between multiple coverages to components proportionately, or on the basis of observable evidence, could better reflect the economics of the separate components.

What's the impact?

If there are indicators that multiple insurance contracts reflect a single contract in substance, then an insurer should apply judgement to determine whether it is appropriate to combine them.

Relevant facts and circumstances to consider may include whether:

- the rights and obligations under the contracts are different when considered together instead of separately; or
- the different risks covered by different insurance contracts are interdependent – e.g. when the risk of one contract offsets or reduces that of the other.

The question of whether to combine contracts might be relevant to certain fronting arrangements.

Separating insurance components of a single contract

TRG meeting, February 2018

What's the issue?

Insurers may combine different types of insurance products, or coverages that have different insurance risks, into one legal insurance contract.

For example, an insurer may provide fire cover for a policyholder’s house and automobile cover for their car under a single contract. Insurers may also hold one legal reinsurance contract to reinsure multiple underlying contracts that may be included in different groups of contracts.

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This raises the question of whether IFRS 17 permits different insurance components of a single legal contract to be separated for measurement purposes.

What did the TRG discuss?

TRG members appeared to agree that, generally, the lowest unit of account used under IFRS 17 is the contract, including all insurance components. Generally, this is consistent with how most insurers design their contracts – i.e. in a way that reflects their substance.

However, the TRG members observed that in some circumstances the legal form of a contract does not reflect the substance of its contractual rights and obligations. In these cases, separating the contract for measurement purposes would be appropriate. The TRG acknowledged that separation of insurance components is not a matter of policy choice, but is an assessment based on judgement considering all relevant facts and circumstances.

However, the TRG members observed that in some circumstances the legal form of a contract does not reflect the substance of its contractual rights and obligations. In these cases, separating the contract for measurement purposes would be appropriate. TRG members acknowledged that separation of insurance components is not a matter of policy choice, but is an assessment based on judgement considering all relevant facts and circumstances.

What's the impact?

If an insurer believes that the legal form of some of the contracts that it issues does not reflect the substance of their contractual rights and obligations, then – as noted by the TRG members – it should apply judgement to determine whether it is appropriate to separate a contract into multiple insurance components.

Relevant facts and circumstances to consider may include whether:

- the insurance components are sold separately;
- the insurance components can be cancelled or lapsed together; or
- the substance of the legal contract is the same as issuing separate contracts.

How an entity identifies its contract will impact various aspects of the accounting under IFRS 17, including the measurement of the contract and its insurance service results.

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Measuring insurance cash flows

Determining how to measure the fulfilment cash flows for insurance contracts.

Noteworthy observations by TRG members

TRG meeting, April 2019

In some interesting discussions on IFRS 17's requirements, TRG members made several noteworthy observations on measuring insurance cash flows.

Recognising changes in inflation assumptions

Assumptions about inflation that are based on an index of prices are treated as relating to financial risk even if the link to the index is not contractual. These changes are recognised as insurance finance income or expense in profit or loss (and other comprehensive income). In contrast, changes in inflation assumptions based on an insurer's expectation of specific price changes do not relate to financial risk.

Considering reinsurance when determining the risk adjustment for non-financial risk

TRG members discussed whether reinsurance should be considered in the risk adjustment for non-financial risk of underlying contracts when an insurer also holds reinsurance. It was clarified that if an insurer considers the availability of reinsurance, including its cost, when determining the compensation it requires for bearing the non-financial risk of underlying contracts, then this would be reflected in the risk adjustment for the underlying contracts. The risk adjustment for reinsurance contracts held is always determined as the risk that is being transferred to the reinsurer.

Recognising changes in fulfilment cash flows that result from changes in underlying items

Some TRG members raised concerns about this topic – the IASB will discuss this matter further at its April 2019 meeting.

The IASB's staff stated that changes to fulfilment cash flows that result from changes in underlying items should not adjust the contractual service margin (CSM) under the general measurement model. For the purposes of IFRS 17, they believe that these changes are considered changes in assumptions that relate to financial risk. The staff plans to recommend that the IASB clarify this.

Although they agreed with this clarification for measurement purposes, some TRG members expressed concern about its impact on the separate presentation of insurance service and investment results, in particular where the changes in underlying items relate to non-financial assumptions – e.g. mortality expectations when insurance contracts are part of underlying items.

Accounting for insurance acquisition cash flows that relate to future contract renewals

International Accounting Standards Board meetings, March and January 2019

What's the issue?

Under IFRS 17, insurance acquisition cash flows are accounted for by including them in the cash flows expected to fulfil contracts in a group of insurance contracts.

These cash flows may comprise commissions paid for new contracts issued that insurers expect policyholders to renew in the future, sometimes more than once. In some cases, the commissions may exceed the margins to cover such costs embedded in the premium for the initial contract because the insurer expects to recover some costs from future renewals of that contract.

If the commission is non-refundable, it has to be covered by the premiums within the 'contract boundary' of the newly issued contract under current IFRS 17 when it is initially recognised. When the expected renewal of the contract is outside the boundary of the newly issued contract, the contract could be

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onerous under IFRS 17.

What did the IASB decide in January 2019?

The IASB tentatively decided to amend IFRS 17 so that insurers would allocate part of the insurance acquisition cash flows directly attributable to newly issued contracts – e.g. initial commissions paid – to expected renewals of those contracts outside the contract boundary. This would address one of the issues discussed by the TRG in February 2018.

As a result of this, insurance acquisition cash flows allocated to future renewals would be recognised as an asset until the expected contract renewals are recognised. The IASB proposes further amendments to the accounting for these assets. In particular, insurers would:

- assess the recoverability of the asset each period before the renewed contracts are recognised, basing the assessment on the expected fulfilment cash flows of the related group of contracts; and
- recognise in profit or loss:
  - any unrecoverable amount as a loss; and
  - any reversal of some or all of this loss when adverse conditions no longer exist.

What did the IASB decide in March 2019?

The IASB tentatively decided to amend the disclosure requirements in IFRS 17 to reflect their January 2019 proposal. This new proposal would require insurers to:

- reconcile the asset created by these cash flows at the beginning and the end of the reporting period and its changes, specifically any loss for lack of recoverability or reversals recognised; and
- provide quantitative disclosures – in appropriate time bands – of when these cash flows are expected to be included in the measurement of the related insurance contracts.

What's the impact?

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

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

In addition, insurers would need to:

- analyse their acquisition costs to identify which ones relate to expected contract renewals outside of the contract boundary;
- allocate costs; and
- evaluate their expectations of future contract renewals beyond contract boundaries.

Applying this amendment would therefore introduce some new steps. The amendment would also require insurers to exercise more judgement when assessing expected future renewals and developing their method for allocating insurance acquisition cash flows.

Insurers using the premium allocation approach would have the option to either:

- expense all insurance acquisition costs up-front and avoid operational complexity and judgement; or
- recognise these costs as an asset.

Therefore, insurers that:

- use the premium allocation approach; and
- choose to expense all insurance acquisition costs up-front,

would also avoid the additional complexity of meeting the proposed new disclosure requirements

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regarding the assets created from insurance acquisition cash flows which relate to future renewals.

By allowing insurers to defer insurance acquisition cash flows relating to future contract renewals, some insurers may recognise fewer onerous contracts on initial recognition. This may impact reinsurance programmes and the relevance of the issue of the accounting mismatch arising from reinsurance of onerous contracts.

Determining discount rates using a top-down approach

TRG meeting, September 2018

What's the issue?

An insurer may determine the discount rates used to measure insurance contracts by basing its calculations on a yield curve reflecting the current market rates of return of a reference portfolio of assets (i.e. using a top-down approach).

In doing so, the insurer needs to adjust the yield curve to eliminate any characteristics of the assets that are not present in the insurance contracts – e.g. credit risk. However, it does not need to adjust for liquidity differences.

A question that arises is whether an insurer can use its own assets as the reference portfolio and, if so, whether changes in those assets should result in changes in the discount rates used to measure insurance contracts if it does not adjust for liquidity differences.

What did the TRG discuss?

TRG members observed that IFRS 17 does not impose any restrictions on the reference portfolio – therefore, it could be a portfolio of assets held by the insurer, as long as the discount rates achieve the objectives of:

- reflecting the characteristics of the insurance contracts; and
- consistency with observable current market prices.

If an insurer uses its own assets as the reference portfolio and – as IFRS 17 permits – does not adjust for liquidity differences, then the changes in the portfolio's liquidity would be reflected in the changes in the discount rates used to measure the related insurance contracts, even if the liquidity characteristics of the insurance contracts themselves have not changed.

Insurers are required to adjust the yield curve of the reference portfolio to eliminate factors (other than liquidity differences) that are irrelevant to insurance contracts – e.g. credit risk changes. Therefore, changes related to credit risk would not impact the discount rate used to measure insurance contracts.

What's the impact?

Insurers will generally endeavour to match assets and liabilities closely, so a reference portfolio based on own assets might be expected to reflect a level of liquidity as similar as possible to that of its issued insurance contracts.

However, some differences will still arise and changes in the liquidity of the reference portfolio would flow through to the measurement of insurance contract liabilities if no adjustment is made for differences in liquidity. This would be the case if a greater proportion of illiquid assets are held – the measurement would reflect greater availability of illiquid investments in the market even though the liquidity characteristics of the insurance contract liabilities have not changed.

To enable financial statement users to compare different insurers, it is essential that IFRS 17's disclosure requirements are applied, particularly in terms of how the insurer:

- identifies a reference portfolio; and
- adjusts the yield curve to determine the discount rates, including whether it adjusts for liquidity differences.

Under IFRS 17, entities are required to disclose significant judgements and changes in those judgements, including with respect to discount rates. Disclosing the effects of changes in the assets in the reference

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portfolio on the discount rates would provide useful information about the sources of changes to the insurance contract liabilities.

Accounting for the risk adjustment in industry pools managed by an association

TRG meeting, September 2018

What's the issue?

In some jurisdictions, all insurers issuing automobile insurance contracts are legally required to be members of a particular association, whose purpose is to provide insurance coverage to policyholders who would otherwise be unable to obtain it. This arrangement includes two types of industry pools.

Pool 1	Pool 2
Some members are appointed to issue contracts that belong to the industry pool on behalf of all members	Members can choose to transfer some insurance contracts they have issued to the industry pool

The results of each industry pool are allocated to all of the members of the association based on a sharing formula. Under current practice, the share of the results is included in each insurer's own financial statements as direct business.

A question arises over how members should account for their share in the results of the industry pool, and whether the risk adjustment for non-financial risk related to contracts in industry pools should be determined at the association level or the individual member level.

What did the TRG discuss?

The terms of a contract need to be analysed to identify the substance of the rights and obligations under the contract and who the issuer is. Facts and circumstances may indicate that contracts in an industry pool are considered to be issued by all members together.

As IFRS 17 provides no specific guidance on contracts with more than one issuer, insurers may need to consider whether other standards apply – including IFRS 11 *Joint Arrangements* – to determine how to reflect their share in the results of industry pools in their financial statements.

The risk adjustment that an insurer requires for non-financial risk reflects the compensation it would require for bearing that risk. Therefore, the risk adjustment reflects the degree of diversification benefits an insurer includes when making this determination.

TRG members observed that issuing a contract within an industry pool arrangement may affect these diversification benefits and, therefore, the risk adjustment. TRG members noted the differing views expressed as to whether the risk adjustment applied to the same group of insurance contracts could differ depending on the reporting level within a group of entities (see Determining the risk adjustment for individual and group reporting purposes).

What's the impact?

Industry pool arrangements are common in many jurisdictions. However, the diverse legal and contractual forms these take will require careful analysis in order to account for them appropriately. It is important to evaluate all relevant facts and circumstances of each arrangement to determine:

- who the issuer of the contracts is;
- how each member should account for its share in the pool; and
- how the risk adjustment for non-financial risk reflects the substance of the arrangements.

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Determining the risk adjustment for individual and group reporting purposes

TRG meeting, May 2018

What's the issue?

The objective of the risk adjustment for non-financial risk is to reflect the entity's perception of the economic burden of the non-financial risk that it bears. Therefore, the risk adjustment for an entity reflects the degree of diversification benefit that it includes when determining the compensation it requires for bearing that risk.

The question that arises is whether an entity or its group can consider diversification benefits beyond the single entity – e.g. those available at the consolidated group level – when determining the risk adjustment.

What did the TRG discuss?

TRG members observed that when determining the risk adjustment, the entity that issues the contracts considers benefits of diversification that occur at a level higher than the entity if, and only if, they have been included when determining the compensation that the issuing entity requires for bearing non-financial risk. This compensation could be evidenced by the capital allocation in a group of entities.

For the purposes of group reporting, two methods were discussed.

The staff and some TRG members believed that determining the risk adjustment involves a single decision made by the entity that issues the contracts. Therefore, the risk adjustment at the consolidated group level should be the same as the risk adjustment at the individual issuing-entity level.

Other TRG members believed that the risk adjustment is based on an entity's perception of the economic burden of the non-financial risk that it bears, and an individual entity within a group may have a different perception of non-financial risks from that of the consolidated group. This could result in different risk adjustments being applied for the same group of insurance contracts depending on the reporting level.

TRG members noted that the method selected by a group of entities should be applied consistently across all groups of insurance contracts.

What's the impact?

Insurers may want to use the same risk adjustment at the consolidated group level and at the individual issuing-entity level for the same group of contracts. This may be operationally simpler than determining multiple risk adjustments for measurement purposes – one at the level of the individual entity that issued the contracts and another at the consolidated group level.

IFRS 17 is principles-based and does not prescribe how to determine the risk adjustment. However, insurers applying IFRS 17 may need to look at:

- how they price business;
- how capital is allocated and target returns are determined; and
- whether issuing entities operate within a group-wide risk appetite and risk management framework that reflects the benefits of group-wide risk diversification.

Insurance acquisition cash flows paid when contracts are issued

TRG meeting, February 2018

What's the issue?

Insurers may unconditionally pay insurance acquisition cash flows – e.g. commissions paid to sales agents – for contracts initially written with the expectation that they will be renewed. Sometimes these acquisition cash flows paid exceed the initial premium charged for the contract.

The insurer generally expects to recover these costs from future renewals. However, if those cash flows are outside the contracts' boundaries, then they cannot be included when measuring the initially written contracts under IFRS 17.

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This raises the question of whether future premiums can be allocated to insurance acquisition cash flows that are unconditionally paid when the contract is issued, if they are partly associated with future renewals.

Update, January 2019: *The IASB has proposed amendments to IFRS 17 that aim to address this issue.*

What did the TRG discuss?

TRG members appeared to agree that any insurance acquisition cash flows that are:

- directly attributable to individual contracts; and
- unconditionally paid on initially written contracts,

should be included in the measurement of the group containing those contracts. Because the costs are paid unconditionally for each initially written contract, they cannot be allocated to future groups recognised on renewal or other groups that do not contain these contracts.

Various TRG members believed that the accounting outcome would not reflect the economic substance of the contract because it would not reflect the insurer's long-term expectations.

The TRG members observed that if the facts and circumstances were different, then the outcome could be different. For example, if the insurance acquisition cash flows were not paid unconditionally, then it might be appropriate to allocate a part to future renewals.

What's the impact?

If a part of the insurance acquisition cash flows cannot be allocated to future renewals, then these types of contracts are more likely to be considered onerous on initial recognition. This is because the entire insurance acquisition cash flow would be reflected in the measurement of the initially written contracts.

When these cash flows result in an onerous contract on initial recognition, it will be in a group of contracts that are onerous on initial recognition. Therefore, contracts within the portfolio that are renewed, and that are expected to be profitable, would not be included within the same group.

When these cash flows result in an onerous contract on initial recognition, it will be in a group of contracts that are onerous on initial recognition. Therefore, contracts within the portfolio that are renewed, and that are expected to be profitable, would not be included within the same group.

Some insurers currently use cost allocation techniques to allocate some insurance acquisition cash flows. These techniques may need to be reviewed and potentially adapted to reflect the approach described above. Insurers may also consider adjusting their terms and conditions for commission payments to make them conditional on future renewals.

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Measuring the CSM

Determining how to measure the CSM.

Level of aggregation

International Accounting Standards Board meeting, February 2020

What's the issue?

IFRS 17 requires an entity to recognise and measure groups of insurance contracts. Groups are determined by:

- identifying portfolios of insurance contracts;
- dividing a portfolio into a minimum of three groups – i.e:
  - those that are onerous on initial recognition;
  - those that on initial recognition have no significant possibility of becoming onerous subsequently; and
  - the remaining contracts in the portfolio; and
- dividing these into groups of contracts not issued more than one year apart (annual cohorts).

Applying the annual cohort requirement is costly when there is sharing of risks between different generations of policyholders. This is because the cash flows of one contract affect or are affected by contracts with other policyholders and also share in the same pool of underlying items as those other contracts (such as mutualised contracts). This is particularly complex if the entity has discretion over how it shares the returns from the underlying items between itself and the policyholders as a whole, or if the contracts are in the scope of the variable fee approach (VFA).

The loss of information about the effect of annual cohorts on the CSM would be limited when:

- the effect of financial guarantees over returns on underlying items in a contract is shared with other policyholders across generations and the entity's remaining share is small; and
- a contract includes only small amounts of 'fixed cash flows' and the effect of changes in these is not shared with other policyholders, which means that the amount of fixed cash flows borne by the entity is small.

Although the IASB did not ask a question on the annual cohort requirement in the exposure draft, the IASB agreed to consider the feedback they received from respondents on applying the annual cohort requirement to insurance contracts with intergenerational sharing of risks between policyholders.

What did the IASB decide?

The IASB has confirmed that the annual cohort requirement in IFRS 17 will remain unchanged. The IASB acknowledged that there may be limited circumstances when the cost of dividing portfolios into annual cohorts may outweigh the benefits. However, the complexity of developing criteria for an exemption could result in interpretation issues and inconsistent application, resulting in disrupting the implementation of IFRS 17 and reducing the benefits of its ongoing application.

What's the impact?

The IASB has now re-confirmed that the annual cohort requirements in IFRS 17 will not change. Entities now need to start focusing on how they will implement these requirements, especially those issuing mutualised contracts.

The IASB has demonstrated that the purpose and benefits of annual cohorts contribute to providing fundamental information about trends in an insurer's profits from insurance contracts over time, including, by:

- preventing onerous insurance contracts from being offset against profitable ones; and

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- ensuring that profits associated with insurance contracts are fully recognised in profit or loss over the coverage period of those contracts.

For some contracts the requirement will be complex and costly to implement and require the exercise of judgement. However, the information provided by annual cohorts is critical to users of financial statements, especially given the current low interest rate environment impacting insurers.

Entities will need to consider how to allocate changes in the amount of the entity's share of the fair value of the underlying items across annual cohorts that share in the same pool of underlying items. This will require significant judgement and entities should consider approaches that will generate useful information to users.

IFRS 17 permits entities to group contracts at a higher level than the annual cohort level if the same accounting outcome can be reached as if annual cohorts were applied. Before entities consider identifying such scenarios, they should evaluate the operational complexity of proving this outcome, not only at inception but on an ongoing basis in all scenarios. For many contracts an entity is exposed to the impact of guarantees, experience gains and losses or other results through its variable fee.

Allocating the CSM under the general measurement model to investment services

International Accounting Standards Board meetings, May, March and January 2019, and February 2020

What's the issue?

Recognition of the CSM in profit or loss under the general measurement model is currently determined by allocating the balance to coverage units, which are based on:

- the quantity of benefits provided under the contracts; and
- the contracts' expected duration.

Under IFRS 17, for insurance contracts that are not contracts with direct participation features, the quantity of benefits and contract duration relate only to insurance coverage and do not take into account any investment services.

The exposure draft (ED) included proposed amendments to allocate the CSM based on coverage units that are determined by considering both insurance coverage and any investment-return service, if certain criteria were met to identify an investment-return service. Feedback included concerns on the scope and operational complexity of the proposed amendment.

What did the IASB decide?

At its meeting in February 2020, the IASB confirmed:

- that entities will be required to identify coverage units for insurance contracts without direct participation features considering the quantity of benefits and expected period of investment-return service, if any, in addition to insurance coverage;
- the criteria for an investment-return service in paragraph 119B of the ED, replacing references to 'positive investment return' with 'investment return';
- the disclosure requirements as proposed in the ED; and
- the addition of an 'insurance contract services' definition in Appendix A in IFRS 17.

The IASB also confirmed an amendment to require an entity to include, as cash flows within the boundary of an insurance contract, costs related to investment activities to the extent the entity performs such activities to enhance benefits from insurance coverage for the policyholder – even if there is no investment-return service.

What's the impact?

Entities would need to assess their insurance contracts to determine whether there is an investment-return service according to the confirmed proposals, which may affect the coverage period and determination of coverage units.

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This means that, where relevant, entities would need to assess the relative weighting of insurance coverage and any investment-return services, and their pattern of delivery, to determine how the CSM is recognised in profit or loss on a systematic and rational basis for insurance contracts accounted for under the general measurement model. Entities may want to consider leveraging their approach for insurance contracts with direct participation features and for contracts that provide more than one type of insurance coverage when making this determination.

This assessment is important because it could affect:

- the timing of profit recognition;
- whether and to what degree related investment costs are included in the fulfilment cash flows; and
- whether insurance contracts qualify for the premium allocation approach, according to the amended definition of coverage period.

The inclusion of investment costs in the fulfilment cash flows may have wide-ranging impacts on entities' systems and processes, profit recognition and financial statement presentation. More specifically, the addition of costs related to investment activities to the extent that the entity is performing the activities to enhance benefits for the policyholder will require entities to assess, and apply judgement, to determine whether certain investment costs are directly attributable to the fulfilment of the insurance contract. This concept of enhancing insurance benefits refers to a circumstance when an entity's investment activities increase the value of the benefit to the policyholder. Additionally, entities will need to consider the inclusion of investment costs in the fulfilment cash flows when determining the discount rate to be applied, to make it consistent with the assumptions for cash flows.

The IASB confirmed that the difference between an investment-return service and a contract where investment activities are used to enhance the benefit to the policyholder is that, without an investment component, the policyholder does not have a right to benefit from investment returns absent an insured event – an important distinction between the two.

When an investment component exists, it may be clear if an investment-return service is being provided. There will be circumstances when no investment-return service is provided but an investment component exists. For example, an entity does not provide an investment-return service if it provides only investment custody services regarding the investment component of an insurance contract. In many other cases, entities will need to use judgement – exercised consistently – in making this assessment.

Entities will be required to disclose quantitative information about the expected CSM release, rather than providing solely qualitative information. This requirement will help users of financial statements understand the profit recognition pattern for different products and enable them to compare those products across entities. It should be noted that this amount is unlikely to be the actual profit arising in future years as effects like the time value of money or experience gains or losses are excluded from the expected CSM release disclosure.

The IASB discussed whether the term 'investment activities' will lead to interpretation issues and the staff agreed to consider the wording in the drafting of the revised version of IFRS 17.

Interim reporting

International Accounting Standards Board meeting, January 2020

What's the issue?

IAS 34 *Interim Financial Reporting* states that the frequency of an entity's reporting should not affect the measurement of its annual results. However, IFRS 17 requires that an entity does not change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements or in the annual reporting period.

IFRS 17 generally requires changes in estimates of fulfilment cash flows related to future periods to adjust the CSM, whereas experience adjustments – i.e. differences between expected and actual cash flows for the current and past period – are recognised in profit or loss immediately. This approach can result in different CSM and revenue for annual financial statements depending on the frequency of an entity's reporting.

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This issue creates particular complexities for groups that issue consolidated interim reports under IAS 34 but whose subsidiaries are not required to do so (or prepare interim reports other than those addressed by IAS 34 or with a different frequency), and vice versa.

The IASB did not propose amending IFRS 17 in this regard in the exposure draft but nevertheless received feedback on this aspect of IFRS 17, specifically that the issue would result in some entities:

- maintaining two sets of accounting estimates; and
- changing existing accounting practices for interim financial statements from a year-to-date basis to a period-to-period basis.

What did the IASB decide in January 2020?

The IASB tentatively decided to amend the requirements relating to interim financial statements in IFRS 17 to require an entity to:

- make an accounting policy choice whether to change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements and in the annual reporting period; and
- apply its choice of accounting policy to all insurance contracts issued and reinsurance contracts held.

What's the impact and what should preparers be doing now?

The choice for entities is whether to:

- adopt a year-to-date approach in presenting their annual financial statements, ignoring results presented in any IAS 34 interim reporting during the year; or
- apply the current IFRS 17 requirement.

The differences that arise between these approaches are likely to be unpredictable (since they arise from changes in estimates) and so entities are likely to consider this accounting policy choice from an operational perspective, while also considering the approach adopted by their peers. During periods in which there are significant changes in estimates, an entity that selects an accounting policy that differs from its peer group is likely to find itself explaining different drivers of its results arising from the timing of how changes in estimates are reflected in its results.

In addition, the basis for accretion of interest will differ. For example, consider an entity that issues half-year reports in compliance with IAS 34. It forms a new group of contracts that will be originated through the year – it will accrete interest on the CSM in the first half of the year using the weighted-average discount rate for that period, and in the second half using the average for the whole year. This may result in a difference in the CSM compared with an entity that does not issue interim reports and therefore would accrete interest on the CSM for all contracts in the group using the weighted-average discount rate for the whole year.

The operational implications are also likely to be complex. Whichever accounting policy election is made, IFRS 17 will require estimates and assumptions to be updated at interim reporting dates.

Some insurers may already have started to build systems and processes to comply with the current requirement in IFRS 17 – many others will need to consider the pros and cons of the accounting policy election now open to them.

Some issues for preparers to consider
• What modifications to current processes, if any, will be needed to update estimates and assumptions at each reporting date?
• How are current interim reporting systems set up – year-to-date or period-to-period?

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• Is the frequency of reporting in line with that of peers?
• How much work has already been undertaken on IFRS 17 interim reporting? What are the potential costs and benefits of change?
• How will the impacts of changes in estimates be reported, depending on the accounting policy selected and seasonality in the business?
• Have second order effects like interest accretion on the CSM been considered? What are the potential impacts if discount rates change significantly during the year?
• Which option are peers likely to adopt, and how will this influence investor expectations?
• How can subsidiaries best align reporting with their parent?
• What are the pros and cons of the accounting policy options available?
• What are the impacts of the proposed accounting policy election on systems, processes and controls?

IFRS 17 – Business combinations – contracts acquired in their settlement period

International Accounting Standards Board meeting, January 2020

What's the requirement?

Under IFRS 17, an entity is required to assess whether a contract meets the definition of an insurance contract based on facts and circumstances at:

- inception, if the entity issued the contract; or
- the date the contract is acquired, if the entity acquired the contract either in a business combination in the scope of IFRS 3 *Business Combinations*, or a transfer of insurance contracts that do not form a business.

This differs from current accounting practice under which, as an exception to IFRS 3, insurance contracts acquired in a business combination or transfer are classified on the basis of contractual terms and other factors at their inception.

In principle, the insurance contracts originally issued by an entity (the acquiree) do not change when acquired by another entity (the acquirer). Following the introduction of IFRS 17, the exemption that permitted the acquirer to classify these contracts on the basis of the contractual terms and other factors at their inception can no longer be applied in accounting for business combinations or transfers. Once IFRS 17 is effective, acquirers will need to classify insurance contracts acquired as at the date of the business combination or transfer. This has the accounting consequence that where contracts are acquired with claims in their settlement period, such contracts are generally classified as if the insured event were the ultimate determination of the cost of the claims.

The assumed obligation would be classified as a liability for remaining coverage as shown below.

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IFRS 17 requirements for treatment of insurance contract in a business combination or portfolio transfer, as currently drafted

As a result, insurance contracts with claims in their settlement period may be treated differently depending on whether they were originated by the entity or were assumed in a business combination or transfer during their settlement period.

This may lead to system changes and related costs for contracts acquired during their settlement period, and some stakeholders believe that it will result in less useful information compared with current practice by insurers.

The IASB did not propose amending IFRS 17's guidance on its application to business combinations and insurance contracts acquired in the transfer of a business that do not form a business combination. However, as a result of comments received from outreach and comment letters it has discussed this topic during its redeliberations.

What did the IASB decide in January 2020?

The IASB confirmed its intention to retain unchanged the guidance in IFRS 17 for insurance contracts acquired in their settlement period. The IASB argued that exempting insurance contracts acquired in a business combination from the general requirements would create complexity for users of financial statements and reduce comparability with other transactions. The IASB noted that it believes it is important to align business combination accounting with other industries.

What's the impact and what should preparers be doing?

Insurers have previously been able to apply a special exemption from the IFRS 3 accounting which applies to insurance contracts. This exemption will no longer be available under IFRS 17, which will impact the accounting for business combinations and portfolio transfers.

Under this revised approach, differences may arise between the identification of the service provided – and associated recognition and release of the CSM – for the same contract between the acquiring entity and the acquiree entity in a business combination or transfer. For example, the acquirer would measure a contract acquired in its settlement period at fair value and recognise a CSM equal to the difference between the fair value and the present value of the fulfilment cash flows, and will recognise the entire fair value as revenue over the estimated settlement period. Determining the fair value and the resulting CSM requires the use of judgement. The acquiree would continue not to recognise a CSM or revenue for insurance contracts in their settlement period.

For insurers who issue short-term contracts – and therefore plan to account for the insurance contracts they issue under the premium allocation approach (PAA) – the removal of the exemption in IFRS 3 may add an additional layer of complexity and cost in accounting for insurance contracts acquired in business combinations and portfolio transfers. Contracts acquired which are expected to have a longer claims settlement period may not be eligible for the PAA in the acquirer's financial statements – the acquiring entity may need to develop systems and processes to measure contracts using the general model and accommodate a CSM.

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Accounting for business combinations and portfolio transfers under IFRS 17 will be challenging. Compared to current requirements, which permit an acquiring insurer to continue to use the classification in accordance with IFRS 4 at inception, certain exemptions have been removed and multiple reassessments may have to take place on acquisition, such as:

- the classification of contracts using the contractual terms and other factors as at that date;
- the determination of the measurement model; and
- the potential need for separation and combination of contracts.

On transition to IFRS 17, a number of simplifications can be applied, but these may not go as far as some hoped. In particular, the IASB has tentatively confirmed that – on transition – an insurer need not recognise a CSM for settlement of claims incurred before an insurance contract was acquired. But this only applies if the contract was acquired before transition and the entity does not have the information to apply the IFRS 17 requirement retrospectively (see article).

Insurers should look at their business combinations that will have occurred before the date of transition – especially businesses acquired in 2020 or 2021 – to see whether this applies. In addition, the process for the accounting analysis of business combinations and transfers after the effective date will change and become substantially more complex.

Allocating the CSM under the general measurement model to reflect investment services

International Accounting Standards Board meetings, June 2018 and May, March and January 2019

What's the issue?

Recognition of the CSM in profit or loss under the general measurement model is currently determined by allocating the balance to coverage units, which are determined by assessing:

- the quantity of benefits provided under the contracts; and
- the contracts' expected duration.

Under IFRS 17, for insurance contracts that are not direct participating contracts, the quantity of benefits and contract duration relate only to insurance coverage and do not take into account any investment-related services.

At its June 2018 meeting, the IASB proposed to clarify the definition of the coverage period for insurance contracts with direct participation features, emphasising that the coverage period for such contracts includes periods in which the insurer provides investment-related services.

What did the IASB decide in January 2019?

The IASB tentatively decided that the CSM under the general measurement model should be allocated based on coverage units that are determined by considering both insurance coverage and any investment return service, a new concept introduced for the purposes of this amendment.

The IASB decided not to develop a prescriptive approach to determine when and to what extent investment-return services are provided. The existence of an investment component is necessary for an investment-return service to be considered in the CSM release, but is not sufficient on its own to demonstrate that an investment-return service exists. Judgement – applied consistently – would be needed to identify an investment-return service.

What did the IASB decide in March 2019?

The IASB tentatively decided to amend the disclosure requirements in IFRS 17, 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 – currently IFRS 17 also allows only qualitative disclosures; and
- specific disclosures about their approach to assessing the relative weighting of the benefits

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provided by insurance coverage and investment-related services or investment return services.

What did the IASB decide in May 2019?

The IASB has tentatively decided that an investment-return service can exist in an insurance contract *only* if:

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

Consistent with its decision in January, the IASB agreed that satisfying the above criteria is necessary, but not sufficient on its own, to demonstrate that an investment-return service exists – further analysis would still be needed to identify an investment-return service.

Some IASB members observed that, for these purposes, a 'positive investment return' does not necessarily equate to a return greater than zero. In a jurisdiction with a negative interest rate environment, a 'positive investment return' could be less than zero as long as the return is still higher than the benchmark yield.

What's the impact?

Insurers would need to assess their insurance contracts to determine whether there is an investment-return service according to the revised proposals, which may affect the coverage period and determination of coverage units.

This means that, where relevant, insurers would need to assess the relative weighting of insurance coverage and any investment-return service and their pattern of delivery, on a systematic and rational basis, to determine how the CSM is recognised in profit or loss for insurance contracts accounted for under the general measurement model.

This decision 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 PAA.

The inclusion of investment-related administrative costs in the fulfilment cash flows would have wide-ranging impacts on insurers' systems and processes, profit recognition and financial statement presentation.

When an investment component exists, it may sometimes be clear whether an investment-return service is being provided. For example, an insurer does not provide an investment-return service if it provides only investment custody services regarding the investment component of an insurance contract. In many other cases, insurers would need to use judgement – exercised consistently – in making this assessment.

Insurers should start evaluating the implications of these proposed changes now. 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. When designing their new processes, insurers should allow scope for adjustment and fine-tuning as the proposals are exposed for comment and eventually finalised.

Insurers will be required to disclose quantitative information about the expected CSM release, rather than provide solely qualitative information. This requirement will help users of financial statements understand the profit recognition pattern for different products and be able to compare those products across entities.

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Example: Investment-return service in an insurance contract with no investment component

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 into an annuity at a future date, after which there would be no period of guaranteed payments.

If the policyholder dies after conversion, but 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 the policyholder can withdraw includes an investment return that is generated by the insurer's investment activity and is expected to be positive.

Applying the annual cohorts requirement to contracts that share in the return of a specified pool of underlying items

TRG meeting, September 2018

What's the issue?

Some insurance contracts share in the return of a specified pool of underlying items, with some of the return contractually passed from one group of policyholders to another – e.g. because of guarantees and proportionate sharing in the returns of the pool.

The basis for conclusions to IFRS 17 explains that, for contracts that fully share risks, the groups of contracts considered together will give the same results as a single combined risk-sharing portfolio.

It adds that IFRS 17 does not specify the methodology to be used to arrive at the reported amounts and in some cases, it is not necessary to restrict groups to annual cohorts to achieve the same accounting outcome.

The question that arises is: when would measuring the CSM at a higher level than an annual cohort level (e.g. portfolio level) achieve the same accounting outcome as measuring it at an annual cohort level?

What did the TRG discuss?

TRG members observed that when contracts share in 100 percent of the returns of a pool of underlying items that includes the insurance contracts themselves, the insurer would not be affected by the expected cash flows of each individual contract issued; and for groups of such contracts, the CSM would be zero. Accordingly, measuring the CSM at a level higher than the annual cohort would achieve the same outcome as applying the annual cohorts requirement.

TRG members observed that where the effects of risk sharing between policyholders comprise less than 100 percent of the returns, the expected cash flows could affect the insurer, resulting in a CSM being recognised for each group. In these cases, insurers would need to determine whether measuring the contracts at a higher level than the annual cohort would still result in the same outcome as applying the annual cohorts requirement.

What's the impact?

Insurers may be able to measure contracts with a risk-sharing mechanism at a higher level than the annual cohort only if they can achieve the same accounting outcome. They would need to assess whether these contracts share risks to an extent that would allow them to achieve that outcome.

Insurers would also be expected to perform an analysis to confirm that the different measurement levels would not impact the measurement outcome.

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Accounting for insurance risk consequent to an incurred claim

TRG meeting, September 2018

What's the issue?

There are certain situations where an incurred claim creates an insurance risk for an insurer that would not exist if no claim were made.

A common example is a disability contract that provides coverage for a policyholder becoming disabled during a specified period. If a claim is made, then the insurer is required to make regular payments to the policyholder until they either recover, reach a specified age or die. In this scenario, the amount of the claim is uncertain and subject to insurance risk.

A question that arises is whether an insurer should record such an obligation as:

- a liability for incurred claims – i.e. the insured event in the example above is the policyholder *becoming* disabled; or
- liability for remaining coverage – i.e. the insured event is the policyholder *becoming and remaining* disabled.

What did the TRG discuss?

TRG members observed that different interpretations of what the insured event is for these types of contracts are possible when applying IFRS 17. Therefore, the obligation may be treated as a liability for incurred claims or a liability for remaining coverage.

TRG members observed that determining the appropriate accounting policy requires the exercise of judgement, based on the specific facts and circumstances, considering which interpretation provides the most useful information about the nature of the services provided. These accounting policies should be applied consistently to similar transactions and over time.

What's the impact?

Whether expected regular payments are classified as a liability for incurred claims or as a liability for remaining coverage has no impact on the cash flows that are included in the insurance contract measurement. However, it directly impacts the determination and allocation of the CSM to profit or loss as shown below.

Accounting for payments to the policyholder	Effect on profit recognition	Effect on recognition of changes in estimates of future cash flows	Complexity of the approach
Liability for incurred claims	Shorter recognition period	Changes are recognised immediately, which can lead to volatility in profit or loss	Less complex
Liability for remaining coverage	Longer recognition period	Volatility related to changes is partly absorbed by the CSM	More complex

In some cases, the classification may also impact the accounting model applicable to the insurance contracts – e.g. whether a group of contracts qualifies for the PAA.

It will be crucial for insurers to make transparent disclosures as required by IFRS 17, including those about significant judgements, to allow financial statement users to understand and compare the performance of insurers.

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How to identify coverage units for CSM allocation (for contracts with no investment components)

TRG meetings, May and February 2018

What's the issue?

The CSM of a group of insurance contracts is recognised in profit or loss based on identifying the coverage units in the group. These are determined by considering, for each contract, the *quantity of benefits* provided and its expected coverage duration.

Due to the variety and complexity of insurance products, determining the quantity of benefits provided under each contract in a group of insurance contracts is an area of judgement.

The question that arises is what factors should be considered in determining the coverage units in a group of contracts, considering both the contracts' expected duration and quantity of benefits.

What did the TRG discuss?

The objective of the release of the CSM is to reflect services provided in each period. Since IFRS 17 does not specify how to determine the coverage units in a group, TRG members agreed that an insurer needs to apply judgement to determine a systematic and rational method for estimating the services provided for each group of contracts.

TRG members observed that coverage units should reflect:

- expectations of lapses and cancellations of contracts, as well as the likelihood of an insured event occurring to the extent that they it would affect the expected duration of contracts in the group; and
- different levels of service across the periods being covered – because the benefits of being able to make a claim are affected by the amount that a policyholder can claim.

Depending on the facts and circumstances, methods that may achieve the objective include:

- a straight-line allocation over the passage of time, reflecting the number of contracts in a group;
- using the maximum contractual cover in each period;
- using the amount that the insurer expects the policyholder to be able to validly claim in each period if an insured event occurs;
- methods based on expected cash flows; and
- methods based on premiums.

It was noted that methods based on premiums would not be appropriate if the premiums:

- are receivable in periods different from those in which services are provided;
- reflect different probabilities of claims for the same type of insured event in different periods (rather than different levels of service of standing ready to meet the claims); or
- reflect different levels of profitability in contracts.

TRG members also appeared to agree that methods that result in no CSM allocation to periods in which the insurer stands ready to meet valid claims would not meet the objective.

What's the impact?

Many groups of insurance contracts will contain contracts with similar risks and levels of cover provided.

For groups like these, a method primarily based on the passage of time that reflects the number of contracts in the group may be a reasonable proxy for services provided in each period.

For other, more complex groups of insurance contracts (e.g. groups that contain contracts with different or multiple risks, or contracts with different levels of cover provided over different periods), other methods would need to be developed to achieve the objective of the CSM release.

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Identifying a practical and systematic approach for determining the quantity of benefits provided by these contracts using information available to the insurer may ease the operational challenges of this new requirement.

How to identify coverage units for CSM allocation (for contracts with investment components)

International Accounting Standards Board meeting, June 2018; TRG meeting, May 2018

What's the issue?

A variety of insurance contracts provide investment-related services. A key question is whether their coverage period and coverage units should be determined with reference to insurance coverage only, or with reference to insurance coverage and the investment-related services. Answering this question is necessary for determining the CSM recognised in profit or loss in each period.

What did the TRG discuss in May 2018?

IFRS 17 identifies direct participating contracts as contracts that provide both insurance services and investment-related services. Based on this, TRG members agreed that, for direct participating contracts, determining the quantity of benefits provided and the expected coverage duration – and hence, the CSM recognised in profit or loss in each period – should reflect both insurance and investment-related services provided under the contract.

For contracts with investment-related services that are not direct participating contracts, the staff and some TRG members believed that, based on the wording of IFRS 17, the coverage period and coverage units are determined by reference to insurance services only. However, most TRG members disagreed that such contracts should be treated as providing only insurance services.

What did the IASB discuss in June 2018?

The IASB decided to amend the definition of the coverage period for direct participating contracts in the next cycle of *Annual Improvements to IFRS*. The amendment would clarify that the coverage period for these contracts includes periods in which the entity provides coverage for insured events or investment-related services.

At a future meeting, the IASB will receive a more comprehensive list of items that have been identified as raising practical, interpretative and other implementation challenges.

Update, January 2019: *The IASB has proposed amendments to IFRS 17 that affect how the CSM would be allocated under the general measurement model to investment services.*

What's the impact?

The proposed amendment for direct participating contracts appears consistent with the way these contracts are identified and accounted for (i.e. applying the VFA) and reflects the contracts' characteristics. Given the wide range of these contracts, assessing the pattern of service provision reflecting both insurance and investment-related services will require judgement.

However, at the May TRG meeting some TRG members observed that if investment-related services provided are reflected in CSM allocation only for direct participating contracts, then this could result in what they believe are economically similar contracts having significantly different recognition patterns, depending on whether they qualify as direct participating contracts or not. This is because they consider that insurance contracts that are not direct participating contracts may still provide significant investment-related services.

Although the June IASB meeting has provided additional clarity, some uncertainty still remains over whether the IASB will hold a substantive discussion about contracts with investment-related services that are not direct participating contracts. Many preparers will want to continue to progress the overall design of their IFRS 17 systems and processes, but will need to be mindful to build in flexibility to accommodate the continuation of this discussion.

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Transitioning to IFRS 17

Applying IFRS 17's transition requirements.

Transition reliefs and minor amendments

International Accounting Standards Board meeting, February 2020

What's the issue?

The ED proposed several minor amendments and editorial corrections to IFRS 17. While there was overall support for many of these, some respondents expressed concerns or asked for clarifications.

Concerns included the challenges of applying the permitted approaches to transition. Feedback ranged from calls for more optionality and flexibility within the approaches to suggestions to provide specific modifications and reliefs.

Subjects	Decision	Reference (to IFRS 17 unless otherwise stated)
Transition reliefs – investment contracts with discretionary participation features	Entities will be permitted to determine whether a contract meets the definition of an 'investment contract with discretionary participation features' using information available at the date of transition where information at inception or initial recognition is not available.	Paragraphs C9 and C21
Transition reliefs – reinsurance contracts held	Entities should assume that a reinsurance contract held was acquired after the underlying insurance contracts were issued in situations where the entity does not have reasonable and supportable information to determine the date of acquisition of the reinsurance contract. This means the reinsurance contract held would not have a loss-recovery component representing the recovery of expected initial losses on the related underlying contracts.	Paragraph C15A
Transition reliefs – interim financial statements	This applies for entities that make an accounting policy choice not to change the treatment of past accounting estimates made in previous interim financial statements. Under the modified retrospective approach, if the entity does not have reasonable and supportable information to apply the accounting policy choice retrospectively, the entities will determine: • the contractual service margin (CSM); • the loss component; and • amounts related to insurance finance income or expenses at the date of transition as if the entity had not prepared	Paragraph B137

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	any interim financial statements before the date of transition.	
Distinct investment components	Entities will apply IFRS 17 to distinct investment components that meet the definition of an investment contract with discretionary participation features.	Paragraph 11
Recognition of contracts	Entities will include only contracts that meet the recognition criteria of paragraph 25 of IFRS 17 in recognising a group of insurance contracts at a reporting date. The recognition date of a contract may be different from the issue date.	Paragraph 28 and to retain, unchanged, paragraph 22
Insurance finance income or expenses	Changes in the measurement of a group of insurance contracts caused by changes in the value of underlying items (excluding additions and withdrawals) are changes arising from the effect of the time value of money and financial risk.	Paragraph B128c
Definition of investment component	To finalise the definition of an investment component referring to a repayment in all circumstances and clarify that policy loans are not necessarily investment components.	Appendix A
Adjustments to CSM under paragraph B96(c)	To clarify that, for insurance contracts without direct participation features, the CSM is not adjusted for changes in fulfilment cash flows arising from differences that relate to the time value of money and assumptions that relate to financial risk between: • any loan to a policyholder expected to become payable in the period; and • the actual loan to the policyholder that becomes payable in the period.	Paragraph B96(c)
Policyholder loans and revenue	Changes to the liability for remaining coverage due to changes in cash flows from loans to policyholders do not give rise to insurance revenue.	Paragraph B123(a)
Experience adjustments for premium receipts	To specify that an entity should present experience adjustments for premium receipts that relate to current or past service as insurance revenue.	Paragraphs 106(a) and B124
Adjustments to CSM under paragraph B96(d)	To clarify that, for insurance contracts without direct participation features, if an entity chooses to disaggregate the change in the risk adjustment for non-financial risk between insurance service result and insurance finance income or expenses, the entity should	Paragraph B96(d)

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	adjust the CSM only for the changes related to non-financial risk, measured at the discount rates determined on initial recognition.	
VFA eligibility test	Confirmed that the eligibility test for the VFA is to be performed on a contract-by-contract basis.	Paragraph B107
Consequential amendment to IFRS 3	To clarify that an entity can continue to classify insurance contracts acquired through a business combination that occurred before the date of initial application of IFRS 17 (and only those business combinations) based on the contractual terms and other factors at the inception of the contract, rather than at the date of acquisition.	IFRS 3
Consequential amendment to IFRS 9	Financial guarantee contracts issued (if not in scope of IFRS 17) are in the scope of IFRS 9, rather than financial guarantee contracts issued or held, as previously specified in the ED.	Paragraph 2.1 of IFRS 9

The IASB proposed no further amendments for additional topics raised by respondents relating to transition reliefs and modifications. These included level of aggregation requirements, application of the fair value approach and modifications for future cash flow estimates.

What's the impact and what should preparers be doing now?

Now that the IASB has confirmed these amendments, preparers can move forward with their implementation plans. While some of these amendments have been referred to as minor, they may have a significant impact on implementation. For example, the confirmation that the VFA eligibility test is performed on a contract basis rather than at a group level and changes to the requirements for adjustments to the CSM may lead to changes in entities' working assumptions. Preparers should review and adjust their working assumptions and implementation plans if necessary.

The amendment regarding interim financial statements follows from a previous decision made in January 2020 by the IASB. This amendment may provide operational relief to preparers but can also have financial implications driven by the significance of changes in estimates, which affects the amount of CSM recognised on transition and released over time.

We now know that there will be no further changes to transition. Transition to IFRS 17 will be challenging and time consuming and preparers should move ahead with executing their transition plans.

Insurance acquisition cash flows on transition to IFRS 17 and on acquisition

International Accounting Standards Board meeting, January 2020

What's the issue?

In the ED, the IASB proposed several amendments to the recognition and measurement of assets for insurance acquisition cash flows (IACF). The IASB received feedback that the amendments did not include how to recognise and measure an asset for IACF at transition. The feedback included suggestions that the IASB provides transition relief and simplified methods to measure an asset for IACF at the date of transition, regardless of which transition approach an entity uses.

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What did the IASB decide in January 2020?

Subjects	Decisions
Asset for IACF at transition	The IASB decided to amend IFRS 17 to require an entity to identify, recognise and measure an asset for IACF at the date of transition.
Using the modified retrospective approach	The IASB decided to amend IFRS 17 to require an entity applying the modified retrospective approach to measure an asset for IACF using information available at the date of transition by: • identifying the amount of IACF paid before the date of transition (excluding the amount relating to the contracts that ceased to exist before the date of transition); and • allocating this amount using the same systematic and rational allocation method that the entity will apply going forward to: o groups of insurance contracts that are already recognised at the date of transition, and o groups of insurance contracts that are expected to be recognised on or after the date of transition. In addition, the IASB decided to require an entity using the modified retrospective approach to: • adjust the CSM of the groups of insurance contracts that are already recognised at the date of transition by deducting the amount of IACF allocated to that group on transition; and • recognise an asset for IACF for the groups of insurance contracts that are expected to be recognised on or after the date of transition.
If no information is available	In circumstances where an entity does not have reasonable and supportable information to apply the modified retrospective approach, the IASB decided that in respect of IACF: • no adjustment will be made to the CSM of the groups of insurance contracts that are recognised at the date of transition; and • the asset for IACF for the groups of insurance contracts that are expected to be recognised after the date of transition will be zero.
The fair value approach	Under the fair value approach, the IASB decided to require an entity to recognise an asset for IACF measured as the amount of IACF that the entity would incur at the date of transition, if the entity had not already paid those IACF to obtain the rights to: • recover IACF from premiums of insurance contracts originated before the date of transition but not yet recognised at the date of transition; or • obtain future contracts (including the expected renewals) after the date of transition without paying again any IACF the entity has already paid. The IASB indicated that the final revised standard will clarify how the above

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	requirements are applied.
Impairment	The IASB clarified that for IACF assets recognised on transition, an entity is not required to apply the recoverability assessment retrospectively – i.e. for the periods that occurred earlier than the date of transition.
Transfers and business combinations	The IASB also decided to amend IFRS 3 and IFRS 17 to require an entity that acquires insurance contracts in a business combination in the scope of IFRS 3, or in a transfer of insurance contracts that do not form a business, to recognise a separate asset for IACF measured at fair value at the date of acquisition.

What's the impact and what should preparers be doing now?

The clarifications are helpful for insurers that incur significant IACF for contracts where renewals are expected at the date of transition. Insurers now have specific requirements to identify, recognise and measure an asset for IACF on transition, including certain simplifications. This means that:

- insurers need to assess what information will be available on IACF at or before transition – including how these cash flows would have been allocated to groups of insurance contracts, what expectations there were about renewals, and how these have changed over time;
- insurers will then need to determine whether they can apply the full retrospective approach to transition, or will need to apply the modified retrospective approach or fair value approach;
- if an insurer determines that it has no reasonable or supportable information available in respect of IACF on transition, then the asset for IACF will be zero on transition unless the fair value approach is applied;
- insurers should measure the asset for IACF on transition by applying the same systematic and rational allocation method that will be applied going forward, so entities will need to consider this as they develop their allocation methodologies; and
- insurers will need to use judgement to determine the amount of the asset for IACF where they have chosen to apply the fair value approach on transition and in any business combination or transfer of insurance contracts that does not form a business.

Transition requirements – Applying the risk mitigation option

International Accounting Standards Board meetings, March and February 2019

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.

The option is prohibited from being applied for 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 – according to some stakeholders – this prohibition may distort revenue recognised for groups of contracts in future periods and equity on transition.

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

At the February 2019 meeting, the IASB voted to retain the requirements in IFRS 17 to prohibit retrospective application of the risk mitigation option. However, it agreed to discuss other potential solutions to this issue at a future meeting.

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What did the IASB decide?

At its March 2019 meeting, the IASB tentatively decided to amend IFRS 17's transition requirements in two ways.

Applying the risk mitigation option prospectively

The IASB tentatively decided to permit 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

The IASB also tentatively decided 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 certain conditions are met.

This is because an insurer can apply the risk mitigation option whenever the relevant criteria are met, as long as it:

- can apply IFRS 17 retrospectively to that group of contracts;
- applies the option as described above; and
- has also used derivatives or reinsurance to mitigate financial risk 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[1] would be measured at fair value, meaning that equity on transition will 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.

What's the impact?

To apply the risk mitigation option prospectively from the date of transition to IFRS 17, insurers will need to plan ahead. Relevant decisions and 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 addresses some preparer concerns but will not address changes in non-financial assumptions – e.g. changes in demographic assumptions – which will be reflected in the CSM. The effect of this may need to be explained to users of the financial statements.

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

1 In January 2019, the IASB proposed amending IFRS 17 to expand the scope of the risk mitigation option to apply when an entity uses reinsurance to mitigate financial risk. Because reinsurance contracts held are not eligible to apply the variable fee approach, changes related to financial risks are recognised in profit or loss similar to derivatives (or in other comprehensive income if an entity makes this election).

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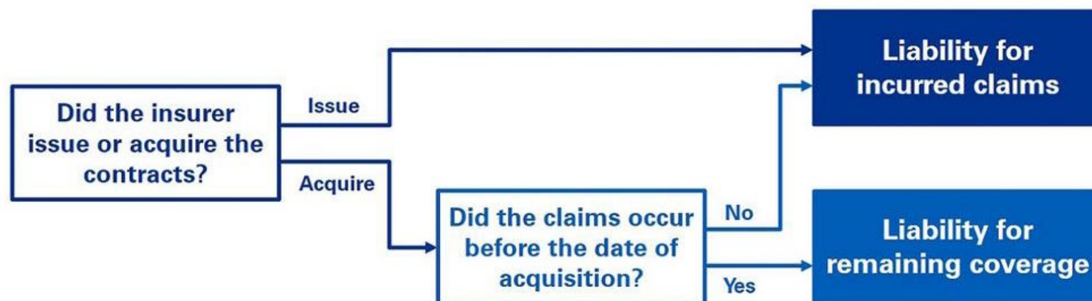
Transition requirements – Additional practical relief for acquired claims liabilities

International Accounting Standards Board meeting, February 2019

What's the issue?

Under IFRS 17, liabilities relating to claims settlement are treated differently depending on whether the insurance contracts were issued by an insurer or acquired in a business combination or portfolio transfer, as shown below.

A challenge arises on transition with respect to the requirement to account for acquired claims liabilities as a liability for remaining coverage, because some insurers use a single system to manage all claims liabilities. As a result, it may be difficult to obtain the required data to separate and measure claims liabilities in two different ways.



What did the IASB decide?

The IASB proposes that a specified modification be added to the modified retrospective approach to transition for the treatment of claims liabilities acquired by an insurer in a business combination or portfolio transfer. Under the amendment, these liabilities would be accounted for as a liability for incurred claims.

An 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.

The IASB has also proposed an amendment to the fair value approach to transition so that an insurer applying this approach could also classify acquired claims liabilities as a liability for incurred claims.

What's the impact?

This amendment will provide a meaningful practical solution when insurers do not have the necessary information to identify acquired claims liabilities on transition and classify them appropriately. In these cases, all claims' liabilities 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 compared with a liability for remaining coverage. There would be no need to determine a CSM on transition for acquired claims liabilities, meaning that no insurance service revenue would subsequently be recognised in the statement of profit or loss.

This amendment would only apply 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 any acquired claims liabilities going forward would be classified as a liability for remaining coverage.

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Transition requirements – Further IASB discussions

International Accounting Standards Board meeting, February 2019

What's the issue?

Stakeholders expressed various other concerns about transition requirements – mostly about comparability, optionality and providing useful information to users of financial statements. The IASB discussed eight of these topics but proposed no amendments in these areas, noting that it believes they do not meet the criteria set by the IASB at its October 2018 meeting.

The IASB reminded stakeholders that the disclosure requirements on transition should help reduce some of these concerns. The IASB also indicated that it would like to explore other ways to address insurers' concerns about the transition requirements.

What can insurers learn from the IASB discussion?

The modified retrospective approach

The IASB considered several stakeholder concerns about the complexity and challenges of the modified retrospective approach, proposing only one amendment. They provided some clarity around the use of estimates, reminding insurers that they are permitted to make estimates when retrospectively applying an accounting policy as described in IAS 8. This principle equally applies to specified modifications in the modified retrospective approach.

Given that only one amendment has been in this area, some insurers may wish to reconsider whether the fair value approach to transition would be simpler.

Restating comparative information

Under IFRS 17, insurers are required to restate comparative information about insurance contracts for the annual reporting period immediately preceding the date of initial application. However, IFRS 9 does not require financial assets to be restated for that same period.

Some stakeholders expressed concern that some insurers would restate comparative information about insurance contracts but not about financial assets, and that this could distort users' understanding of those insurers' performance.

Preparers will need to balance managing the costs and resources of restating their financial assets' accounting with users' needs.

Identifying cash flows that are known to have occurred

Stakeholders have expressed concerns about identifying actual cash flows that are known to have occurred when estimating future cash flows at the date of initial recognition on transition. The IASB clarified that if data is not available about the actual cash flows that occurred, then insurers are required to use reasonable and supportable information to estimate those amounts.

Using reasonable and supportable information

The IASB reminded stakeholders that determining whether information is reasonable and supportable when transitioning to IFRS 17 may require assessment and careful consideration, and that practice would need to develop in this area.

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Effective date of IFRS 17

International Accounting Standards Board meeting, November 2018

Proposed one-year deferral to 2022

The IASB has voted to propose a one-year deferral of the effective date of IFRS 17, and the fixed expiry date of the optional temporary exemption from applying IFRS 9 granted to insurers meeting certain criteria.

The IASB's tentative decision means that all companies preparing financial statements under IFRS Accounting Standards would be required to apply both IFRS 9 and IFRS 17 for annual periods beginning on or after 1 January 2022.

Update, April 2019: *The IASB has reiterated its tentative decisions to defer the effective date of IFRS 17 and extend the temporary exemption from applying IFRS 9 to 1 January 2022.*

Identifying insurance acquisition cash flows when applying the fair value transition approach

TRG meeting, February 2018

What's the issue?

IACF are generally included in the measurement of the CSM, and a portion of the insurance revenue and expense recognised in a period includes amounts related to them.

When applying the fair value approach to transition, an insurer determines the CSM for a group of contracts at the date of transition based on the difference between the fair value of the group and the fulfilment cash flows of the group at that date.

A question has arisen over whether IACF that occurred before the date of transition are required to be identified and recognised as revenue and expense in reporting periods after the date of transition.

What did the TRG discuss?

TRG members appeared to agree that when applying the fair value approach on transition to IFRS 17, the measurement of the CSM does not include IACF that occurred before the date of transition. Therefore, these cash flows are not included in insurance revenue and expenses in reporting periods after the date of transition.

What's the impact?

This discussion should alleviate any concerns that an insurer would be required to identify IACF that occurred before the date of transition when applying the fair value approach.

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Defining contract boundaries

Distinguishing between cash flows relating to existing and future contracts.

Cash flows that are outside the contract boundary on initial recognition

TRG meeting, September 2018

What's the issue?

An insurer's practical ability to reprice an insurance contract at a future date can affect the amount of estimated future cash flows it recognises within that contract's boundary. At the September meeting, TRG members focused on cash flows that are outside the contract boundary on initial recognition and how to account for changes in circumstances related to these future cash flows.

The question that arises is how to account for these future cash flows in subsequent periods.

For example, how should an insurer account for the exercise of a renewal option if cash flows related to renewal periods were outside the contract boundary to begin with? Should the exercise of the option be accounted for as the extension of the existing contract or as a new contract?

What did the TRG discuss?

TRG members observed that cash flows may fall outside of the contract boundary because the insurer has a right to reprice premiums related to future insurance coverage periods – e.g. renewal periods. If these cash flows eventually occur, they would be considered cash flows arising from the substantive rights and obligations of a new contract.

This means that cash flows relating to the same legal contract could possibly fall into more than one group of insurance contracts when accounting for them under IFRS 17.

TRG members also observed that some cash flows may be outside the contract boundary on initial recognition because constraints limiting an insurer's ability to reprice the contract had no commercial substance. If circumstances change and these constraints gain commercial substance, then these cash flows that were once outside the contract boundary may then fall inside the boundary. When contract boundaries are reassessed in this manner, the CSM of the existing group of contracts needs to be adjusted.

What's the impact?

IFRS 17 may require an insurer to separate what is currently thought of as one contract into several shorter duration contracts, for example if there is a unilateral repricing option relating to future coverage periods.

The observations made in this and previous discussions about contract boundaries emphasise the need to fully understand the substantive rights and obligations of insurance contracts when applying the contract boundary requirements.

Determining contract boundaries requires careful analysis and may require significant changes to systems and processes.

Accounting for group insurance policies

TRG meeting, September 2018

What's the issue?

An insurer may write a group contract under which it provides insurance coverage to the members of an association or to the customers of a bank, referred to as certificate holders.

In the situation under consideration, the insurer has the right to terminate this policy at any time with a 90-

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day notice period which, in turn, terminates the insurance coverage for all of the certificate holders.

This raises three questions.

- Is the policyholder the association/bank or the individual certificate holders?
- Is this a single insurance contract or multiple insurance contracts?
- What is the contract boundary?

What did the TRG discuss?

Identifying the policyholder

TRG members considered which of the parties to the contract would be compensated for an insured event. They observed that when an insurer repays the debt of a certificate holder to a bank as a result of an insured event that adversely affects the certificate holder, the individual certificate holder is the one being compensated even though the bank receives the payment. Therefore, the certificate holder is the policyholder in this arrangement.

Considering whether it is a single contract or multiple contracts

TRG members observed that relevant factors might include whether:

- the insurance contract is priced and sold separately to each certificate holder
- the certificate holders are connected to one another; and
- the insurance coverage is an optional purchase for each individual.

TRG members observed that there is significant judgement involved in concluding whether the substance of the policy reflects multiple contracts with individual certificate holders or a single contract with an association or bank.

Defining the contract boundary

TRG members observed that in this particular case the contract boundary is 90 days because the insurer's substantive obligation to provide services under a contract ends at the point that it can terminate the contract.

What's the impact?

Group policy terms and conditions can vary widely in their structure, and this is a timely reminder that in preparing for IFRS 17 insurers have to analyse all the relevant facts and circumstances of each arrangement to determine:

- who the policyholder is;
- whether in substance it is indeed a single contract or multiple contracts under IFRS 17 (see also Separating insurance components of a single contract); and
- which cash flows are included in its measurement (see also Boundaries of contracts with annual renewable terms).

Considering constraints when assessing the contract boundary

TRG meeting, May 2018

What's the issue?

When an insurer has a substantive obligation to provide services to its policyholders, the cash flows that arise from the substantive rights and obligations are within the contract boundary and are included within the measurement of the group of contracts to which they relate.

A substantive obligation to provide services ends when the insurer has the practical ability to reassess the risks of the particular policyholder (or of the portfolio of insurance contracts) and, as a result, can set a price or a level of benefits that fully reflects the reassessed risks.

A question that arises is what constraints may limit an insurer's practical ability to reprice a contract.

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What did the TRG discuss?

Under IFRS 17, an insurer's practical ability is not constrained if it can:

- set the same price it would for a new contract with the same characteristics as the existing contracts issued on that date; or
- amend the benefits to be consistent with the price it will charge.

TRG members agreed that a constraint that applies equally to new contracts and existing contracts would not limit an insurer's practical ability to reprice existing contracts to reflect their reassessed risks.

Given that IFRS 17 does not specify the sources of potential constraints on these reassessments, it does not limit these constraints to those of a contractual, legal or regulatory nature.

What's the impact?

It may be more readily apparent when regulatory or legal requirements impose constraints on an insurer's practical ability to reprice its contracts than market and other constraints.

When making this assessment, it will be important to consider whether market or other constraints apply equally to all insurers operating in the same jurisdiction for new and renewed contracts. If all insurers can reprice 'as good as new' – i.e. how they would set prices on new contracts – then there is effectively no constraint on their practical ability to reprice for the purpose of assessing the contract boundary.

Contract boundaries for contracts with the option to add coverage

TRG meeting, May 2018

What's the issue?

Insurers may issue contracts that give the policyholders the option to add insurance coverage at a future date. If a policyholder exercises that option, then the insurer is obliged to provide additional coverage.

The question that arises is whether the expected cash flows resulting from the future exercise of the option are included within the contract boundary, and therefore within the measurement of the group of contracts that it relates to.

What did the TRG discuss?

TRG members observed that before determining the contract boundary at the inception of an insurance contract, an insurer should consider whether:

- the contract needs to be separated into multiple insurance components to reflect the insurer's rights and obligations under the contract (see Separating insurance components of a single contract);
- and the obligation to provide additional coverage at a future date is substantive.

TRG members appeared to agree that as long as the option:

- is not considered to be a separate contract; and
- reflects a substantive obligation at inception,

the insurer should assess the contract boundary for the entire contract, including the option.

TRG members also observed that the cash flows related to such an option would be:

- outside the contract boundary if the insurer has the practical ability to reprice the whole contract when the policyholder exercises the option; and
- inside the contract boundary if the insurer has the practical ability to reprice only the additional future coverage when the policyholder exercises the option.

TRG members expressed different views about whether an option would create substantive rights and

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obligations if the insurer sets the premiums for the additional coverage only when the policyholder exercises the option.

In addition, it was noted that the insurer's intention to reassess risk or reprice is irrelevant to the contract boundary assessment – i.e. the contract boundary ends when the insurer has the practical ability to reprice the whole contract, even if it is unlikely to actually exercise its right to reprice.

What's the impact?

To determine whether cash flows are inside the contract boundary of an existing insurance contract, insurers need to evaluate whether these contracts need to be separated into multiple insurance components. If not, insurers need to consider whether providing the policyholder with an option to acquire future additional coverage gives rise to substantive rights and obligations.

Currently, when measuring insurance contracts that give the policyholders the option to add insurance coverage at a future date, it is common to consider the premium for each component (i.e. the base contract and the option) separately. Under IFRS 17, if the rights and obligations related to the option are substantive and the contract is not separated into multiple components, then the contract boundary is established for the contract as a whole. Insurers may need to develop new estimates for some of the cash flows in order to measure these contracts under IFRS 17.

Boundaries of contracts with annual renewable terms

TRG meeting, February 2018

What's the issue?

Step-rated yearly renewable term contracts and unit-linked contracts with additional insurance benefits contain several features that could impact the accounting under IFRS 17. Contracts, like these, contain all or some of the following.

Contract feature	Further details
Annual renewal guarantee	The contract is guaranteed renewable every year
Annual premium increases	Increases in premiums/insurance fees are set at inception and based on the policyholder's age
Annual repricing mechanism	The insurer can reprice the premium/insurance fee annually, based on the emergence of risks within the portfolio to which the contract belongs – i.e. there is no further underwriting of the individual policyholder

These features raise the question of whether the different cash flows on initial recognition should include expected cash flows that relate to expected renewals after the next annual repricing date – i.e. whether the contract boundary should be greater than one year.

What did the TRG discuss?

TRG members appeared to agree that insurers should only consider the ability to reassess and reprice policyholder risks when determining contract boundaries. They observed that *policyholder* risks are risks *transferred from the policyholder to the insurer*. The IASB staff noted that these can include insurance and financial risks but exclude risks that are not transferred from the policyholder to the insurer under such contracts – e.g. lapse and expense risk.

TRG members also noted a distinction between repricing based on a reassessment of:

- portfolio risks based on the emergence of risk within the existing portfolio; and

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- more general community risks based on the emergence of risk within a broader group of policyholders.

The former was the subject of the types of contracts discussed above and would therefore result in a contract boundary that excludes expected future contract renewals.

What's the impact?

Management needs to consider all of the terms and conditions when assessing the contract boundary under IFRS 17, including which risks are reassessed and repriced and at what level.

Under IFRS 17, the boundaries of these contracts may be limited to the year for which premiums have been received.

One possible outcome of having shorter contract boundaries might be that contracts initially written and priced to reflect an insurer's expectation of future renewals are measured in a manner that does not reflect that expectation. This may cause contracts to be considered onerous when they are initially written (e.g. due to significant IACF incurred when the contract is initially written) and only profitable if and when they are renewed. This is considered further in Measuring insurance cash flows.

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Direct participating contracts

Applying IFRS 17's requirements for direct participating contracts.

Risk mitigation option

International Accounting Standards Board meeting, February 2020

What's the issue?

IFRS 17 allows entities to apply the risk mitigation option where they use derivatives to mitigate financial risk arising from insurance contracts with direct participation features. The IASB confirmed in December 2019 that the risk mitigation option would be extended to apply to entities that purchase reinsurance contracts held to mitigate this financial risk. The risk mitigation option permits an entity to recognise the effect of some or all of the changes in financial risk on insurance contracts with direct participation features in profit or loss, when they would otherwise adjust the CSM. This option is provided to eliminate accounting mismatches that would otherwise occur when such derivatives or reinsurance contracts are not underlying items of the direct participation contracts concerned.

Insurers provided feedback to the IASB that accounting mismatches would also arise when non-derivative financial assets are used to mitigate financial risk that arises from insurance contracts with direct participation features.

What did the IASB decide?

The IASB has decided to extend the risk mitigation option in paragraph B115 of IFRS 17. The option will be extended to permit an entity that uses non-derivative financial assets, measured at FVTPL, to mitigate financial risk that arises from insurance contracts with direct participation features.

What's the impact and what's next?

This extension will provide additional relief for many insurers with insurance contracts with direct participation. The application of the risk mitigation option, where permitted, might reduce the accounting mismatch that arises from application of B113(b) of IFRS 17 to insurance contracts with direct participation features. If applied, this option means that the effect of applicable changes in financial risk not arising from the underlying items can be recognised immediately in profit or loss, as will gains and losses on qualifying assets held by the entity to mitigate those effects. The application of this option may highlight any ineffectiveness in an entity's risk mitigation strategy.

The risk mitigation option may also provide partial relief for entities in relation to accounting mismatches for contracts that change in nature over time – which was an issue raised by some respondents. For example, a contract with a savings phase that provides an option to convert to an annuity at a guaranteed rate may be required to apply the VFA, while an annuity contract without the savings phase would typically apply the general measurement model. Applying the risk mitigation option in its revised form would allow the entity to recognise the effects of applicable changes in financial risk not arising from underlying items directly in profit or loss for both the insurance contracts, together with the effects of non-derivative financial assets used to mitigate financial risk.

These issues are not entirely resolved as the risk mitigation option cannot be applied to periods before the date of transition to IFRS 17 and retrospective application is not permitted. The risk mitigation option can be applied prospectively from the date of transition onwards, but will not resolve an accounting mismatch that is already present at transition. Further relief may be provided by applying the fair value approach to contracts that meet the criteria for use of the risk mitigation option.

Application of the risk mitigation option is subject to the eligibility criteria of B116 of IFRS 17. Insurers wishing to explore the use of the extended risk mitigation option for insurance contracts with direct participation features should check that they have a documented risk management objective and strategy for mitigating financial risk using relevant non-derivative financial assets, derivatives or reinsurance contracts held.

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Accounting for direct participating contracts when reinsurance contracts held are used to mitigate financial risk

International Accounting Standards Board meeting, January 2019

What's the issue?

An insurer may use derivatives to mitigate the financial risks arising from the direct participating contracts it issues. This could give rise to an accounting mismatch because the change in the derivatives' fair value is recognised immediately in profit or loss under IFRS 9. However, under the VFA, the related change in the insurance contracts' value is generally accounted for by adjusting the CSM, rather than being recognised immediately in profit or loss.

To avoid this accounting mismatch, IFRS 17 permits an insurer to take account of the effect of risk mitigation, allowing it not to adjust the CSM for the change in financial risk but to recognise that change in profit or loss instead, subject to certain conditions being met (the 'risk mitigation option').

Some reinsurance contracts are structured in a way that enables the cedant to transfer 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 VFA.

This is because reinsurance contracts are ineligible for the VFA. As a result, changes in the financial risk of the reinsurance held are recognised in profit or loss (or other comprehensive income), while the change in the financial risks of the underlying contracts adjusts the CSM.

Under current IFRS 17, the risk mitigation option that is available to reduce mismatches like these is only available when an insurer uses a derivative to mitigate financial risk.

What did the IASB decide?

The IASB's tentative decision 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 not to adjust the CSM when either a derivative or a *reinsurance contract held* is used for risk mitigation purposes, subject to specific conditions being met.

What's the impact?

The IASB's discussion has confirmed that reinsurance contracts held are not eligible for the VFA, even if the underlying contracts are direct participating contracts. This is consistent with the view that a reinsurance contract held should be accounted for separately from the underlying contracts issued.

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 VFA. This is because both the changes in the fulfilment cash flows of reinsurance contracts arising from the effects of financial risk and the corresponding changes in those of the direct participating contracts adjust the CSM.

The proposed expanded option could address accounting mismatches that arise when reinsurance contracts that are not underlying items are held 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.

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Accounting for reinsurance contracts held

Assessing how to account for reinsurance contracts held by an insurer.

Accounting for recovery of losses on initial recognition through reinsurance held

International Accounting Standards Board meeting, December 2019

What's the issue?

The exposure draft (ED) proposed an amendment to the measurement of a group of reinsurance contracts held. That proposed amendment would require an entity to adjust the contractual service margin (CSM) of a group of reinsurance contracts held that provide 'proportionate coverage', and as a result recognise income, when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to the group.

The IASB received feedback from respondents that, while they supported the objective of this change, they found the definition of 'proportionate coverage' too narrow and took the view that the amendment would only apply to a few reinsurance contracts. Some respondents expressed concern that the proposed calculation of income for reinsurance contracts held was too restrictive, whereas others were concerned that it could result in an entity recognising income on a reinsurance contract that is in a net cost position.

What did the IASB decide in December 2019?

The IASB did not identify a reason to change the definition, but instead decided to extend the scope of the proposed amendment to apply to any type of reinsurance contracts held – i.e. not limited to proportionate reinsurance. This would allow an entity to adjust the CSM of a group of reinsurance contracts held, and as a result recognise income:

- when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts; or
- on addition of onerous contracts to that group.

The IASB also decided to amend the proposed calculation of income as a consequence of extending the scope above. The revised proposed calculation would require an entity to determine the amount of a loss recovered from a reinsurance contract held by multiplying:

- the loss recognised on the group of the underlying insurance contracts; and
- the percentage of claims on underlying insurance contracts the entity expects to recover from the reinsurance contract held.

The IASB also decided to confirm that the amendment to IFRS 17 would only apply when the reinsurance contract held is recognised before, or at the same time as, the loss is recognised on the underlying insurance contracts. The accounting mismatch that the proposed amendment addresses cannot exist on initial recognition of a loss on an underlying contract, if the reinsurance contract held does not exist at the time that the loss is recognised. This limits the possibility of abuse of the proposed amendment. It will also have implications when accounting for reinsurance contracts held which provide coverage for underlying contracts issued both before and after initial recognition of the reinsurance contract.

What's the impact and what should preparers be doing now?

Accounting for reinsurance held has been seen as one of the most complex parts of IFRS 17 and one that insurers have paused, knowing that there were some significant amendments under discussion.

Those uncertainties have now been resolved – the complexities on contract boundary remain but this amendment is broader than many had dared hope for. It will broaden the circumstances in which an entity can recognise income on reinsurance held when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or adds onerous contracts to a group of contracts. Insurers will now be able to apply the amendment to any type of reinsurance contracts held, which aims to

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provide better information about the economic effect of those reinsurance contracts held by reducing accounting mismatches.

The amendments assume that the loss on insurance contracts is caused solely by claims. In cases where the reinsurer's share in the direct insurer's losses differs overall from the share in claims, more or less profit from the reinsurance contract is recognised, depending on the circumstances.

Companies might need to consider:

- updating their plans to reflect these changes;
- assessing and classifying reinsurance contracts if not already performed – generally using the general measurement model for multi-year treaties;
- determining when and how reinsurance contracts held are initially recognised, how their contract boundaries are to be determined and how future underlying business yet to be written should be included;
- assessing whether commissions and reinstatement premiums in reinsurance contracts held are contingent on premiums or claims and recharacterising them accordingly;
- developing appropriate assumptions, level of aggregation and coverage units for reinsurance contracts held, which may differ from underlying business if reinsurance treaties cover multiple portfolios and underlying business from different regions, and building up projections accordingly;
- working through the impact of these changes on systems and processes – modelling gross and reinsurance cash flows separately for assumed business and reinsurance held;
- developing a methodology to account for intra-group reinsurance (which may vary depending on whether the focus is on solo or consolidated financial statements);
- ensuring disclosures about reinsurance contracts held provide information to users about the nature of the gain and loss components recognised;
- shifting the mindset from reporting results of underlying policies and reinsurance held together to separate recognition and measurement under IFRS 17; and
- analysing the calculation method across all the different types of reinsurance contracts held to assess the impact on profit or loss recognition profiles.

Having worked through the operational aspects of these changes, insurers will want to work through their commercial implications– e.g. can the results of reinsurance contracts held be optimised by amending repricing rights or changing the basis on which risks attach? The basis of reporting reinsurance contracts held is changing due to IFRS 17 and insurers will need to consider how best to communicate this to users and investors.

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Accounting for reinsurance of onerous insurance contracts

International Accounting Standards Board meeting, January 2019

What's the issue?

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

After initial recognition, if a group of insurance contracts that underlies a group of reinsurance contracts held becomes onerous, then the resulting changes in the fulfilment cash flows of the group of reinsurance contracts held is recognised in profit or loss. This avoids accounting mismatches that would arise otherwise.

What did the IASB decide?

The IASB has tentatively decided to propose amendments to IFRS 17 to address the accounting mismatch at initial recognition.

The amendments would require an insurer that recognises losses on underlying insurance contracts assessed as onerous on initial recognition, to also recognise a gain at the same time in profit or loss on reinsurance contracts held, to the extent that the reinsurance contracts cover the losses of the underlying contracts on a proportionate basis.

This gain would apply only to reinsurance contracts entered into before – or at the same time as – the onerous underlying contracts are issued.

The amendments would apply to contracts measured under the PAA and the general measurement model.

What's the impact?

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

The IASB's discussion clarified that the amendment applies to reinsurance contracts covering *claims* of each underlying contract on a *proportionate* basis, which will require careful drafting as the standard is updated. This scope differs from what is commonly known as proportional reinsurance, under which both claims and premiums are proportional to those of the underlying insurance contract. Non-proportionate reinsurance contracts are not covered by the amendment given there is no direct linkage between the underlying onerous contracts and the reinsurance contracts held.

As the IASB's discussions on reinsurance contracts held progress, insurers will need to continue developing new systems and processes to account for these contracts under IFRS 17 and may consider impacts on reinsurance programmes. They will have to consider how these activities could be impacted by the proposed amendments for reinsurance accounting.

Boundaries of reinsurance contracts with repricing mechanisms

TRG meeting, May 2018

What's the issue?

Some reinsurance contracts include terms that allow the reinsurer to reprice the remaining coverage under a contract prospectively, after giving notice to the cedant. Only if the reinsurer provides notice of repricing does the cedant have the right to terminate cover mid-term.

These features raise the question of whether an insurer holding such a contract should include in the contract boundary all expected cash flows on initial recognition, or only the expected future cash flows up until the end of the notice period.

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What did the TRG discuss?

Previously, TRG members observed that cash flows within the boundary of a reinsurance contract held arise from the substantive rights and obligations of the cedant (see Boundaries of reinsurance contracts held).

For reinsurance contracts held:

- a substantive right is a right to receive services from the reinsurer; and
- a substantive obligation is an obligation to pay amounts to the reinsurer – i.e. the reinsurer can compel the cedant to pay reinsurance premiums.

Therefore, cash flows are within the contract boundary of a reinsurance contract held if they arise from substantive rights and obligations that exist during the reporting period in which the cedant:

- is compelled to pay amounts to the reinsurer; *or*
- has a substantive right to receive services from the reinsurer.

The TRG members observed that since the cedant does not have control over its ability to terminate the coverage of the reinsurance contract, it remains compelled to pay premiums to the reinsurer. Therefore, the contract boundary for the cedant would include expected cash flows after the notice period.

What's the impact?

In some cases, the cedant can be compelled to pay reinsurance premiums for reinsurance contracts held. This obligation might impact the cash flows that will be used to measure the reinsurance contract.

Insurers should carefully analyse the terms and conditions of the reinsurance contracts that they hold and all of the relevant facts and circumstances to determine the contract boundary. This involves looking at the rights and obligations of both parties to the contract.

Boundaries of reinsurance contracts held

TRG meeting, February 2018

What's the issue?

IFRS 17's contract boundary requirements – which determine which cash flows are included in the measurement of contracts – appear to use terminology specific to insurance contracts *issued* by insurers.

This raises a question over how the requirements should be applied to reinsurance contracts *held* by insurers.

What did the TRG discuss?

TRG members appeared to agree that these requirements should be adapted in an appropriate way for determining the contract boundaries of reinsurance contracts held. Therefore, cash flows are within the boundary of a reinsurance contract held when the entity has a substantive right to receive services from the reinsurer.

This substantive right ends when the reinsurer:

- has the practical ability to reassess the risks transferred to it; and
- can set a price or level of benefits for the contract that fully reflects the reassessed risk.

What's the impact?

Many reinsurance contracts provide coverage for claims that occur on underlying contracts that are issued during a period of time.

Currently, most insurers holding these reinsurance contracts recognise and measure them to the extent the underlying contracts are written – i.e. without reflecting expectations of future underlying contracts that will be covered by the reinsurance contract held.

This may change under IFRS 17, because the initial and subsequent measurement of the reinsurance

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contract held can include cash flows from underlying contracts that are expected to be issued in the future if they are considered to be inside the boundaries of the reinsurance contract.

Consequently, the recognition pattern for reinsurance costs could change for many insurers. The processes and systems that are used to measure reinsurance contracts held might also need to change.

Insurers should analyse the terms and conditions of the reinsurance contracts they hold. For example, a term that provides the reinsurer with the ability to stop covering future underlying contracts with a few months' notice, which is common in practice, might limit the cash flows included within the contract boundary.

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Presentation and disclosure requirements

Determining what to disclose and how to disclose it under IFRS 17.

Presentation of insurance contract assets and liabilities

International Accounting Standards Board meeting, December 2018

Proposed amendment to IFRS 17

The IASB voted to propose a narrow-scope amendment to IFRS 17's presentation requirements at its December 2018 meeting.

The IASB's proposal aims to provide practical relief to insurers by requiring them to present insurance contract assets and liabilities on the balance sheet at the portfolio level – a higher level of aggregation than currently required by IFRS 17.

Ceding commissions and reinstatement premiums

TRG meeting, September 2018

What's the issue?

Ceding commissions paid to the cedant and reinstatement premiums paid to the reinsurer after an insured event has occurred are common features of reinsurance contracts.

A question arises over whether the reinsurer should consider these amounts:

- part of premiums – i.e. revenue; or
- part of claims – i.e. insurance service expenses.

What did the TRG discuss?

TRG members observed that the reinsurer, like the cedant, should look at the economic effect of the exchanges with the cedant to determine the appropriate presentation. Considering the economic effect of each feature means considering whether cash flows ultimately exchanged between the parties are contingent on claims, regardless of whether they are described as 'commissions', 'premiums' or 'claims'. TRG members made the following observations.

Economic effect of cash flows	Accounting treatment
Not contingent on claims	The feature has the same economic effect as charging a lower (or higher) premium and should be presented as part of insurance revenue.
Contingent on claims	The feature has the same economic effect as reimbursing a higher (or lower) amount of claims and should be presented as part of insurance service expenses.

What's the impact?

The TRG discussion emphasises that the form or title of contractual cash flows does not determine their presentation – their economic effect does. This may result in changes from existing practice, as some reinsurers currently present ceding commissions as expenses (including some fixed commissions as acquisition costs) – these may need to be netted against revenue when applying IFRS 17. Also, reinstatement premiums are commonly presented as additional income under current practice. Under IFRS 17, these may reduce insurance service expenses instead.

If the classification of cash flows as premiums or claims changes when compared with current practice, then this will affect the ratios commonly used as key performance measures by reinsurers.

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