

Amendments to IFRS 17 Insurance Contracts

Issues paper on the forthcoming Exposure Draft

Introduction and purpose

- 1 This issues paper covers the following topics in the Appendix whereby changes are proposed by the IASB:
 - (a) Topic 1A - Loans that transfer significant insurance risk;
 - (b) Topic 1B - Credit cards that provide insurance coverage;
 - (c) Topic 2 - Allocation of acquisition costs to expected contract renewals;
 - (d) Topic 3 - Simplified balance sheet presentation;
 - (e) Topic 4 - Extension of risk mitigation option;
 - (f) Topic 5A - Transition relief for business combinations;
 - (g) Topic 5B - Transition relief for risk mitigation – transition date and fair value approach; and
 - (h) Topic 6 - Annual improvements.
- 2 The purpose of this paper is to prepare for the upcoming Exposure Draft on amendments to IFRS 17 *Insurance Contracts*. Considering the tight timeline for discussing and agreeing on the Draft Comment Letter, this paper aims at obtaining written input from members, so that the discussion in the next physical meeting could focus on the EFRAG issues that remain unaddressed.
- 3 For each of the topics listed above, the EFRAG Secretariat has drafted a proposed wording to include in the Draft Comment Letter. The wording has been prepared on the basis of the IASB Staff Papers and the IASB tentative decisions. Should the final wording of the ED require further refining of the drafting, the specific topic will be considered in the physical meeting.

Appendix - EFRAG's responses to the IASB tentative decisions

Topic 1A - Loans that transfer significant insurance risk

Notes to constituents – Summary of proposals

4 To be completed.

EFRAG's response

EFRAG supports the proposal to permit entities, on portfolio level, to either apply IFRS 17 or IFRS 9 to insurance contracts that provide insurance coverage only for the settlement of the policyholder's obligation created by the contract.

However, EFRAG suggests that, for the comparative period, the proposed amendment also makes reference to IAS 39 *Financial Instruments: Recognition and Measurement* to allow entities to continue to apply IAS 39 in the comparative period should they do not want to restate comparative information under IFRS 9.

- 5 EFRAG supports the proposals to either apply IFRS 17 or IFRS 9 for loans that transfer significant insurance risk on a portfolio level. This is because EFRAG considers that it would reduce the complexity around bifurcating certain loans from insurance contracts or treating such loans as insurance contracts. EFRAG also acknowledges that the proposed amendments would enable:
- (a) an entity that mainly issues insurance contracts to apply IFRS 17 to these loans, permitting comparability with the other insurance contracts issued by the same entity; and
 - (b) an entity that mainly issues financial instruments to apply IFRS 9 to these loans, permitting comparability with the financial instruments issued by the same entity, without imposing IFRS 17 implementation costs for such contracts to the entity.
- 6 EFRAG have been informed that some entities currently apply IAS 39 *Financial Instruments: Recognition and Measurement* to insurance contracts that provide insurance coverage only for the settlement of the policyholder's obligation created by the contract. In the event that entities do not choose to apply IFRS 9 before 2023, they will continue to apply IAS 39 in the comparative period. The proposed amendment under IFRS 17 currently makes reference only to IFRS 9. Therefore, EFRAG suggests the proposed amendment should also make reference to IAS 39 to allow entities to continue to apply IAS 39 in the comparative period should they not restate comparative information under IFRS 9.

Question to EFRAG members

- 7 Do EFRAG members agree with the drafting relating to insurance contracts that provide insurance coverage only for the settlement of the policyholder's obligation created by the contract? Please explain.

Topic 1B - Credit cards that provide insurance coverage

Notes to constituents – Summary of proposals

8 To be completed.

EFRAG's response

EFRAG agrees with the exclusion of certain credit cards that provide insurance coverage from the scope of IFRS 17 as it was never the intention for these types of products to be captured by the standard.

- 9 EFRAG agrees with the proposed amendment to exclude from the scope of IFRS 17 those credit card contracts that provide insurance coverage for which 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.
- 10 EFRAG notes that these products are aimed at providing coverage for credit risk rather than insurance risk and therefore EFRAG agrees that the appropriate accounting for these contracts is by applying IFRS 9 *Financial Instruments*.
- 11 EFRAG acknowledges that currently entities that issue certain credit card contracts typically account for:
- (a) loans or loan commitments in credit card contracts (and any relevant interest revenue) applying IFRS 9;
 - (b) any insurance obligations applying IFRS 4 *Insurance Contracts*, in a similar manner to applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
 - (c) any revenue for providing other services applying IFRS 15 *Revenue from Contracts with Customers*.
- 12 It is for this reason that EFRAG considers that excluding from the scope of IFRS 17 these credit card contracts would:
- (a) permit the continuation of the existing accounting practice and therefore reduce IFRS 17 implementation costs for some entities; and
 - (b) not result in a significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements. Other relevant IFRS Standards would apply to such credit card contracts and would provide relevant information about the components of those contracts to users of financial statements.

Question to EFRAG members

- 13 Do EFRAG members agree with the drafting relating to credit cards that provide insurance coverage? Please explain.

Topic 2 - Allocation of acquisition costs to expected contract renewals

Notes to constituents – Summary of proposals

14 *To be completed.*

EFRAG's response

EFRAG supports the IASB proposals with regards to the treatment of acquisition costs as the resulting financial information will better reflect the economic substance of these transactions.

- 15 EFRAG notes that, from a commercial perspective, an insurer's decision to pay a certain level of acquisition costs might take into account its expectation of contract renewals. EFRAG also acknowledges that some contracts would be treated as onerous due to the allocation of acquisition costs in full to them (i.e. ignoring the impact of renewals).
- 16 EFRAG therefore supports the proposed amendments because this will provide more relevant information to users of financial statements by better reflecting the economic substance and general understanding of these transactions.

Question to EFRAG members

- 17 Do EFRAG members agree with the drafting of this topic on the allocation of acquisition costs to expected contract renewals? Please explain.

Note to EFRAG members

- 18 *This topic will be further discussed in the physical meeting once the final wording for the assessment of recoverability will be available in the ED.*

Topic 3 - Simplified balance sheet presentation

Notes to constituents – Summary of proposals

19 To be completed.

EFRAG's response

EFRAG agrees with the proposed amendments, as considers that the proposed amendments would simplify processes for preparers decreasing the costs of implementation without significantly reducing the information available to users.

- 20 EFRAG considers information about separate assets and liabilities as required under IAS 1 *Presentation of Financial Statements* provides useful information. However, the requirements in IFRS 17 raised concerns that the requirements around disclosures of groups of assets and liabilities may significantly increase the costs of implementation of IFRS 17 without providing commensurate benefits to users.
- 21 EFRAG understands that users do not consider that the proposed change on presentation on a portfolio level would significantly reduce the usefulness of the resulting information, even though the information will be provided on a less granular basis. They considered that off-setting is already present within groups. In addition, EFRAG has not been made aware that the proposals would unduly disrupt implementation processes that are already under way.
- 22 Therefore, EFRAG supports the proposed amendments.

Question to Constituents who are Users

- 23 Do Users agree with separate balance sheet presentation (of insurance contracts that are in an asset position from those that are in a liability position) on a portfolio level rather than at group level? Please explain.

Question to EFRAG members

- 24 Do EFRAG members agree with the drafting of this topic on simplified balance sheet presentation? Please explain.

Topic 4 - Extension of risk mitigation option

Notes to constituents – Summary of proposals

25 To be completed.

EFRAG's response

EFRAG supports the IASB proposals because it addresses an accounting mismatch that arises from using reinsurance held to mitigate financial risks.

- 26 EFRAG notes that the risk mitigation exception under IFRS 17 relating to the use of derivatives was created in order to address an accounting mismatch relating to financial risk introduced by the variable fee approach.
- 27 However, there may be an accounting mismatch similar to the accounting mismatch created when an entity uses derivatives as some entities purchase reinsurance to mitigate financial risks of underlying insurance contracts that apply the variable fee approach.
- 28 The accounting mismatch is most apparent when the effect of financial risk for the reinsurance held would be recognised in profit or loss but for the underlying contracts, the effect of financial risk would be recognised in the contractual service margin instead of being recognised also in profit or loss.
- 29 Therefore, in order to address this accounting mismatch, EFRAG supports the IASB proposals to extend the scope of the risk mitigation option to reinsurance contracts held.

Question to EFRAG members

- 30 Do EFRAG members agree with the drafting of this topic on the extension of the risk mitigation option? Please explain.

Topic 5A - Transition relief for business combinations

Notes to constituents – Summary of proposals

31 *To be completed.*

EFRAG's response

EFRAG supports the IASB's proposals on transition relief for business combinations for both the modified retrospective approach and fair value approach. This is because both the contracts acquired and contracts issued by the acquirer are managed in the same way making it difficult to distinguish between them.

- 32 EFRAG supports the IASB's proposals for both the modified retrospective approach and fair value approach for the following reasons:
- (a) In some cases, when an entity acquires insurance contracts in a portfolio transfer or via a business combination, these contracts are managed in such a way that it is difficult to distinguish between those contracts acquired as a liability for remaining coverage and contracts issued by the entity as a liability for incurred claims; and
 - (b) Claims management systems include all claims regardless of whether they relate to contracts the entity issued or claims acquired.

Question to EFRAG members

- 33 Do EFRAG members agree with the drafting of this topic on transition relief for business combinations? Please explain.

Topic 5B - Transition relief for risk mitigation – transition date and fair value approach

Notes to constituents – Summary of proposals

34 *To be completed.*

EFRAG's response

EFRAG notes that applying the risk mitigation approach from the transition date addresses accounting mismatches in comparative periods but not in periods prior to transition.

EFRAG prefers retrospective application of the risk mitigation relief for variable fee contracts in case entities are able to prove using reasonable and supportable information that a hedging strategy was in place before application of IFRS 17. Even with such a proof being provided, EFRAG is aware that this may raise questions on the use of hindsight being applied.

Therefore, because of the effective date of IFRS 17 and given that another solution may take a considerable amount of time to develop, EFRAG considers that the IASB's proposals are a trade-off between the reliability of information collated retrospectively and the relevance of reflecting the risk mitigation that had been in place.

As a result, on balance, EFRAG supports the proposals by the IASB.

- 35 EFRAG notes that the risk mitigation relief is applicable prospectively as from the IFRS 17 transition date.
- 36 EFRAG considers that entities should be able to apply this risk mitigation relief retrospectively for contracts that apply the variable fee approach in case entities are able to prove using reasonable and supportable information that a hedging strategy was in place before application of IFRS 17.. Otherwise, even with the proposed amendments there would be accounting mismatches in periods prior to transition where a retrospective method is applied as it will result in a contractual service margin that does not reflect risk mitigation activities from previous periods which would distort:
- (a) the equity of entities - because the effect of previous changes in the fair value of the derivatives will be included in the equity, while the corresponding effect on the insurance contracts will be included in the measurement of the insurance contracts (through the contractual service margin); and
 - (b) the revenue recognised for these groups of contracts in future periods - because the contractual service margin includes the changes in financial risks that would have been excluded had the risk mitigation option been applied retrospectively.
- 37 Even when entities are able to demonstrate the existence of previously existing hedging strategies, EFRAG acknowledges that applying risk mitigation retrospectively may raise questions of using hindsight.
- 38 However, bearing in mind the effective date of IFRS 17 and given the fact that another solution might take a considerable amount of time to develop, EFRAG considers the IASB proposals to be a trade-off between the reliability of information collated retrospectively (and the potential risk of entities using hindsight) and the relevance of reflecting the risk mitigation that had been in place.
- 39 Therefore, on balance EFRAG supports the IASB's proposals for the application of the risk mitigation option and the fair value approach prospectively as from the date of transition.

Question to EFRAG members

- 40 Do EFRAG members agree with the drafting of this topic on transition relief for risk mitigation relating to the transition date and fair value approach? Please explain.

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Topic 6 - Annual improvements

Notes to constituents – Summary of proposals

- 41 In June 2018, IASB tentatively decided to propose the following (as part of annual improvements to IFRS standards)
- (a) to amend the terminology in paragraph 27 of IFRS 17 to include insurance acquisition cash flows relating to insurance contracts in the group yet to be issued.
 - (b) to amend the terminology in paragraph 28 of IFRS 17 to achieve the intended timing of recognition of contracts within a group.
 - (c) to remove requirements that could result in double-counting of the risk-adjustment for non-financial risk in the insurance contracts reconciliation disclosures and revenue analyses.
 - (d) to correct the terminology in the sensitivity analysis disclosures.
 - (e) to exclude business combinations under common control from the scope of the requirements for business combinations in IFRS 17.
 - (f) to amend IFRS 3 Business Combinations so that the amendment made by IFRS 17 on the classification of insurance contracts applies prospectively.
 - (g) to amend IFRS 7 Financial Instruments: Disclosures, IFRS 9 Financial Instruments and IAS 32 Financial Instruments: Presentation to achieve the intended scopes of these financial instruments Standards and the scope of IFRS 17, particularly with respect to insurance contracts held.
 - (h) to add an explanation that, in Example 9 of the Illustrative Examples on IFRS 17, the time value of the guarantee changes over time.
- 42 In April 2019 the IASB tentatively decided to:
- (a) amend paragraph B96(c) of IFRS 17 to exclude changes relating to the time value of money and financial risk from the adjustment to the contractual service margin.
 - (b) amend paragraph B96(d) and B97(a) of IFRS 17 to address disaggregation of changes in the risk adjustment for non-financial risk.
 - (c) amend paragraph B118 of IFRS 17 to clarify that an entity can discontinue the use of the risk mitigation option to a group of insurance contracts only if the eligibility criteria for the group cease to apply.
 - (d) clarify the definition of an investment component.
 - (e) amend paragraph 11(b) of IFRS 17 to ensure IFRS 17 applies to investment contracts with discretionary participation features.
 - (f) amend paragraph 48(a) and paragraph 50(b) of IFRS 17 to adjust the loss component for changes in the risk adjustment for non-financial risk.
 - (g) amend paragraph B128 of IFRS 17 to clarify that changes in the measurement of a group of insurance contracts caused by changes in underlying items should, for the purposes of IFRS 17, be treated as changes in investments and hence as changes related to the time value of money or assumptions that relate to financial risk.

EFRAG's response

EFRAG supports the IASB's proposals on the annual improvements because EFRAG considers them to provide useful information.

- 43 EFRAG supports the IASB's proposals relating to the annual improvements as EFRAG agrees that they provide useful information to clarify the wording in the standard or to make corrections or to address minor unintended consequences/conflicts.

Question to Constituents

- 44 Do Constituents agree with the minor amendments proposed by the IASB? Please explain.

Question to EFRAG members

- 45 Do EFRAG members agree with the drafting of this topic on annual improvements? Please explain.

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