

STAFF PAPER

January 2020

IASB[®] meeting

Project	Amendments to IFRS 17		
Paper topic	Scope exclusion from IFRS 17 for some credit card contracts		
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Purpose of the paper

1. This paper discusses staff analysis and recommendations about the amendment proposed in the Exposure Draft *Amendments to IFRS 17* relating to a scope exclusion from IFRS 17 *Insurance Contracts* for some credit card contracts that meet the definition of an insurance contract. This paper follows the tentative decision of the International Accounting Standards Board (Board), at its November 2019 meeting, to consider further the feedback from outreach and comment letters on this proposed amendment.

Summary of staff recommendations

2. The staff recommend the Board confirm the proposed scope exclusion from IFRS 17, with some changes, as follows:

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, the entity is required to:

- (a) separate that insurance coverage component and apply IFRS 17 to it; and
 - (b) apply other applicable IFRS Standards, such as IFRS 9 *Financial Instruments*, to the other components of the credit card contract.
3. The staff also recommend the Board extend the amendment described in paragraph 2 of this paper to other contracts that provide credit or payment arrangements that are similar to such credit card contracts 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.

Structure of the paper

4. This paper provides:
- (a) an overview of the proposals in the Exposure Draft;
 - (b) a summary of the feedback; and
 - (c) the staff analysis, recommendations and questions for Board members.
5. The appendix to this paper includes relevant extracts of the Basis for Conclusions on the Exposure Draft.

Proposals in the Exposure Draft

6. The Exposure Draft proposed that an entity would be 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. The Exposure Draft proposed a corresponding amendment to IFRS 9 to include such credit card contracts (that are financial instruments) within the scope of IFRS 9.

Feedback

7. Of the respondents who commented on the proposal for credit card contracts discussed in paragraph 6 of this paper, many respondents generally agreed with the Board’s proposal and rationale. However, some of those respondents asked the Board to clarify or reconsider particular aspects of the proposal. The comments from those respondents are discussed in paragraphs 9–14 of this paper.
8. A small number of respondents disagreed with the Board’s proposal. These respondents expressed the following views:
 - (a) an entity should be required to apply IFRS 17 to all credit card contracts that meet the definition of an insurance contract in order to appropriately reflect the insurance feature in those contracts; or
 - (b) an entity should be permitted a choice to apply either IFRS 17 or IFRS 9 to the credit card contracts described in the proposal (for example, in order to ensure consistency with choices available in IFRS 17 for fixed-fee service contracts and financial guarantee contracts).

Applying IFRS 9 to some credit card contracts that meet the definition of an insurance contract

9. Some respondents expressed concerns that, applying the proposed amendment, an entity likely would be required to measure the credit card contract at fair value through profit or loss (FVPL) applying IFRS 9. Those respondents noted that if an entity provides the insurance coverage as part of the contractual terms of the credit card (rather than only as a result of law or regulation), the entity must include those insurance coverage-related cash flows in its assessment of the contractual cash flows characteristics of the financial asset. Specifically, the entity would include such cash flows in its assessment of whether the contractual terms of the financial asset gives rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding (SPPI

test).¹ Those respondents noted that such credit card contracts likely would ‘fail’ the SPPI test and, therefore, would be required to be measured at FVPL. Some of those respondents expressed the view that measuring such credit card contracts at FVPL would not be appropriate and provided suggestions to avoid this outcome, including:

- (a) amending the SPPI test in IFRS 9—for example, to specify that the cash flows relating to the insurance coverage would be disregarded for the purposes of the SPPI test. They said this accounting would be comparable to the accounting for credit card contracts that provide insurance coverage only as a result of law or regulation.²
- (b) amending the proposal to account separately for the insurance coverage component of the credit card contract applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

10. A small number of respondents suggested the Board clarify whether the proposed amendment would require an entity to apply IFRS 9 to the credit card contract in its entirety, or whether other IFRS Standards might also apply—for example, IFRS 15 *Revenue from Contracts with Customers* might apply to an obligation to provide access to airport lounges. Similarly, a small number of respondents expressed the view that the Board should not prescribe which IFRS Standards apply to a credit card contract once it is excluded from the scope of IFRS 17. Those respondents said this would ensure that any obligations bundled with the insurance coverage component and the financial instrument component (that form the credit card contract) are accounted for applying the applicable IFRS Standard.

11. Another respondent noted that a credit card contract may be viewed as a combination of a financial asset (ie a drawn down loan financial asset) and an undrawn loan commitment, as explained in paragraphs BC5.256 and BC5.261 of the Basis for Conclusions on

¹ Paragraphs 4.1.1(b), 4.1.2(b) and 4.1.2A(b) of IFRS 9.

² As explained in paragraph BC4.191 of the Basis for Conclusions on IFRS 9, IFRS 9 requires the holder of a financial asset to analyse the contractual terms to determine whether the asset gives rise to cash flows that are solely payments of principal and interest on the principal amount outstanding. The holder would not consider the payments that arise only as a result of regulation as cash flows in its analysis because that regulation and the related payments are not contractual terms of the financial instrument (see paragraph B4.1.13 of IFRS 9, Instrument E).

IFRS 9, as well as other components that are within the scope of other IFRS Standards such as IFRS 15. This respondent expressed the view that if the contractual terms of such a credit card contract include cash flows related to an insurance coverage obligation, then it is unclear whether those insurance coverage-related cash flows would be considered to be part of the financial asset (and would result in the financial asset being measured at FVPL as discussed in paragraph 9 of this paper) or part of something else. This respondent said that if these insurance coverage cash flows are not considered to be part of the financial asset, then they might be considered to be part of any undrawn loan commitment. In that case, such cash flows would effectively be excluded from the scope of IFRS 9 in cases where only the impairment requirements of IFRS 9 are applied to the loan commitment.³ The impairment requirements in IFRS 9 would not capture the effect of the insurance coverage because it is not a cash shortfall—ie the insurance coverage would relieve the customer from its payment obligation such that the amount would no longer be contractually due. In this case, the insurance coverage would effectively be excluded from the measurement requirements in IFRS 9 because only expected credit losses are measured. Furthermore, the respondent said that if these insurance coverage-related cash flows are not considered to be part of the financial asset and the credit card contract does not have an undrawn loan commitment component (for example, the credit card might be fully drawn), then the cash flows might be considered to be a financial liability within the scope of IFRS 9. In this case, the respondent said it is unclear how the measurement requirements in IFRS 9 would be meaningfully applied to that financial liability.

Scope of the proposals

12. Some respondents—including banks and auditors / accounting firms—generally agreed with the Board’s proposal to exclude particular credit card contracts from the scope of IFRS 17 but suggested that the Board extend this proposal to other ‘similar’ contracts that

³ Only some loan commitments are within the scope of IFRS 9 (paragraph 2.3). For many loan commitments, only the impairment (and derecognition) requirements apply (paragraph 2.1(g)). The Board decided to require an entity to apply the impairment requirements to these loan commitments to enable a consistent expected credit loss model to be applied to drawn and undrawn loans.

meet the definition of an insurance contract. These respondents provided examples of such contracts, including debit cards, charge cards, consumer financing contracts, current and deposit accounts and overdraft facilities.

13. In addition, some respondents expressed the view that the proposal should limit the type of insurance coverage that is captured by the proposal—for example, the proposed exclusion from the scope of IFRS 17 should apply only to credit card contracts with insurance coverage that relates to indemnity for losses arising from the use of the credit card.
14. Some of these respondents provided drafting suggestions for how the Board could amend the scope of the proposal, for example:
 - (a) credit card, debit card, charge cards, overdraft facilities and other similar 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 (see IFRS 9). In such contracts, the entity typically extends short-term credit to the customer, with the insurance component being a de minimis component of the contract's value.
 - (b) credit card or other contracts with similar features 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 (see IFRS 9).
 - (c) credit card contracts, and other contracts to provide credit or payment arrangements for the purchase of goods or non-insurance services, 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 and the insurance coverage relates only to indemnity for losses arising from use of the arrangement (for example, for defective goods and services purchased using the credit or payment services provided under the contract).

- (d) credit cards, debit cards and charge cards (or credit cards and similar instruments).

Staff analysis and recommendations

15. As discussed in paragraph 7 of this paper, many of the respondents that commented on the proposal for credit card contracts discussed in paragraph 6 of this paper generally agreed with the Board’s proposal. That proposal would require that an entity 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—ie these respondents generally agreed that entities should not apply IFRS 17 to such credit card contracts in their entirety.
16. In addition, the staff think the Board does not need to consider further the concerns and suggestions from respondents discussed in paragraph 8 of this paper. The Board considered these matters when developing the Exposure Draft and the staff have not identified points the Board did not consider previously. Specifically, as explained in paragraphs BC14–BC15 of the Basis for Conclusions on the Exposure Draft:
 - (a) the Board considered whether an entity should apply IFRS 17 to the credit card contracts discussed in paragraph 6 of this paper. IFRS 9 and IFRS 17 both have requirements that can address credit risk and insurance risk, which are prominent features of such credit card contracts. IFRS 9 is more focused on credit risk and IFRS 17 is more focused on insurance risk. The Board noted there is a balance between the usefulness of the information about such contracts that would be provided by applying IFRS 9 and the usefulness of the information about such contracts that would be provided by applying IFRS 17.
 - (b) when an entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer, the Board concluded that IFRS 9 would provide more useful

information about those contracts. In contrast, when the entity does reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer, the Board concluded that IFRS 17 would provide more useful information about those contracts.

- (c) hence, the Board decided that the Standard to be applied should not be a matter of choice. Furthermore, the Board has not been made aware of entities applying insurance contract accounting practices today to credit card contracts for which the entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer.
17. However, the staff think the Board should consider further some of the concerns and suggestions from respondents discussed in paragraphs 9–14 of this paper.
18. Accordingly, the staff have analysed the following two matters:
- (a) whether applying IFRS 9 to the credit card contracts within the scope of the proposal provides useful information in all cases; and
 - (b) whether the proposal should be extended to ‘similar’ contracts and, if so, which ones.

Applying IFRS 9 to some credit card contracts that meet the definition of an insurance contract

19. The staff note that, as a consequence of the focus in IFRS 9 on contractual cash flows, applying the proposed amendment, if an entity provides the insurance coverage as part of the contractual terms of the credit card contract, the entity must include those insurance coverage-related cash flows when it applies the SPPI test to a financial asset (ie the funded loan arising on the use of the credit card). If a financial asset ‘fails’ the SPPI test as a result of those cash flows, the entity must measure it at FVPL. In contrast, if the entity provides the insurance coverage only as a result of law or regulation, the entity would not consider those cash flows when it applies the SPPI test to a financial asset. The

Board acknowledged those outcomes when developing the Exposure Draft and the staff have not identified points the Board did not consider previously.

20. However, the staff acknowledge the respondent’s observation discussed in paragraph 11 of this paper that a credit card contract may be viewed as a combination of a financial asset (ie a drawn down loan that would be subject to the SPPI test) and a loan commitment (ie an undrawn amount). The staff agree with the respondent that only the impairment (and derecognition) requirements in IFRS 9 apply to many loan commitments. The impairment requirements in IFRS 9 would not capture the effect of the insurance coverage because such an effect is not cash shortfall—ie the insurance coverage relieves the customer from its repayment obligation such that the amount is no longer contractually due. Therefore, in this case, the measurement of an undrawn loan commitment would exclude the insurance component. The staff also agree that, in some cases, the insurance coverage-related cash flows might be considered to be a financial liability within the scope of IFRS 9 (for example, when the obligation for the insurance coverage exists after the customer has repaid its credit card balance) and the measurement requirements in IFRS 9 may not provide useful information about this liability.
21. Accordingly, the staff think that IFRS 9 may not provide useful information about some of the financial instruments that would be newly within its scope applying the proposal in the Exposure Draft (or, more specifically, IFRS 9 may not provide useful information about a credit card contract if it is undrawn or has been repaid). The staff have considered the following possible approaches to amend the proposal in the Exposure Draft to address these concerns:
- (a) Approach A—Require an entity 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 insurance coverage is provided to the customer as part of the contractual terms of such a credit card contract, the entity would be required to measure the credit card contract—in its entirety—at FVPL applying IFRS 9.

- (b) Approach B—Require an entity 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, the entity would be required to separate that component and apply IFRS 17 to it. The entity would be required to apply other applicable IFRS Standards, such as IFRS 9, to the other components of the credit card contract.
22. This paper does not consider an approach that would amend the SPPI test in IFRS 9 (for example, to specify that the contractual cash flows relating to the insurance coverage would be disregarded for the purpose of that test) as discussed in paragraph 9 of this paper. The staff note that the SPPI test is a principle-based assessment with an objective to identify financial instruments with ‘simple’ cash flows that represent solely principal and interest (ie that are consistent with a ‘basic lending arrangement’) for which the effective interest method provides useful information. The staff think the SPPI test would appropriately identify that insurance coverage-related contractual cash flows are inconsistent with a basic lending arrangement—ie such cash flows are not simple cash flows that represent only principal and interest. Accordingly, the staff think that amortised cost measurement would not provide useful information for such credit card contracts in their entirety. In addition, the staff observe that the suggestion to amend the SPPI test would not address the concern discussed in paragraph 11 of this paper that, in some cases, the insurance coverage related cash flows might be considered to be a financial liability within the scope of IFRS 9. That is because the SPPI test applies only to financial assets.
23. This paper also does not consider an approach that would separate the insurance coverage component and apply IAS 37 (rather than IFRS 17) to it as discussed in paragraph 9 of this paper. That is because we think IFRS 17, which was developed specifically for insurance contracts, is the most applicable IFRS Standard for the insurance coverage components discussed in this paper.

Approach A—Require an entity to measure some credit card contracts in their entirety at FVPL applying IFRS 9

24. Approach A would require an entity to measure a credit card contract in its entirety at FVPL if the entity provides the insurance coverage to the customer as part of the contractual terms of such a credit card contract. This approach would be in contrast to the existing requirements in IFRS 9, which would account separately for a loan commitment (to the extent the credit card is unutilised), a financial asset (to the extent the credit card has been used) and a financial liability (to the extent a financial obligation remains after the financial asset has been repaid).⁴
25. The staff think the advantage of this approach would be that the entity would reflect the effect of the insurance coverage in the measurement of the credit card contract as soon as the contract is initially recognised and until it is derecognised (rather than only when the loan is drawn and the SPPI test is applied to that financial asset). This would address the concern discussed in paragraph 20 of this paper that, applying the proposal, only the impairment requirements in IFRS 9 would apply to many loan commitments (unutilised credit card limits) and those requirements would not capture the effect of the insurance coverage in the measurement of such loan commitments. Similarly it would address the concern that, applying the proposal, in some cases the insurance coverage-related cash flows might be considered to be a financial liability within the scope of IFRS 9 (for example, when the obligation for the insurance coverage exists after the customer has repaid its credit card balance) and the measurement requirements in IFRS 9 may not provide useful information about this liability.
26. However, this approach would override the requirements in IFRS 9 that otherwise would apply to these financial instruments. More specifically, as discussed in paragraph 24 of this paper, IFRS 9 would account separately for a loan commitment (to the extent the credit card is unutilised), a financial asset (to the extent the credit card has been used) and a financial liability (to the extent that an financial obligation remains after the financial

⁴ For example, as discussed in paragraph 20 of this paper, this may be the case if there is an obligation to reimburse the credit card holder in the event that an item purchased with the credit card is defective after the holder repays the credit card balance.

asset has been repaid), whereas Approach A would account for ‘the credit card contract’ as a single item—and require FVPL measurement for it. Approach A would increase complexity in the accounting for financial instruments and reduce comparability in the accounting for credit card contracts; for example, it would increase the number of different accounting treatments in IFRS 9 for loan commitments. In addition, the staff think there is risk of unintended consequences of overriding the recognition and measurement requirements in IFRS 9. Furthermore, this approach would measure more items at FVPL compared to the proposal in the Exposure Draft, which would exacerbate:

- (a) the differences between credit card contracts that provide the insurance coverage as part of the contractual terms of the credit card and credit card contracts that provide the insurance coverage only as a result of law or regulation; and
- (b) the concerns from respondents discussed in paragraph 9 of this paper.

Approach B—Require an entity to account separately for the insurance coverage component and the other components in some credit card contracts

- 27. Approach B would require an entity to separate some credit card contracts into insurance and non-insurance components. More specifically, if the entity provides the insurance coverage to the customer as part of the contractual terms of such a credit card contract, Approach B would require the entity to separate that component and apply IFRS 17 to it. The entity would be required to apply other applicable IFRS Standards, such as IFRS 9, to the other components of the credit card contract.
- 28. The staff acknowledge that this approach would introduce separation requirements to contracts that would otherwise be accounted in their entirety applying IFRS 9 (or applying IFRS 17 if the Board had not proposed the scope exclusion discussed in this paper) and such separation adds complexity to the accounting for the credit card contracts within the scope of the proposal.

29. However, the staff note that requiring an entity to account for the insurance coverage component in a credit card contract applying IFRS 17 and the other components of such credit card contracts applying other applicable IFRS Standards would achieve the objective of the Exposure Draft—ie to address concerns that, for some entities that currently apply accounting policies consistent with IFRS 9 or IAS 39 *Financial Instruments: Recognition and Measurement* to some credit card contracts that meet the definition of an insurance contract, the costs of applying IFRS 17 to those credit card contracts in their entirety would exceed the benefits.
30. In addition, the staff note that this approach would address respondents’ concerns that the measurement requirements in IFRS 9 would not provide useful information about some of the financial instruments that would be newly within its scope applying the proposal in the Exposure Draft. The staff think applying IFRS 9 to the financial instrument component—and IFRS 17 to the insurance coverage component—would result in useful information without requiring any changes to the underlying measurement requirements in either Standard.
31. Finally, Approach B would improve comparability between credit card contracts that provide insurance coverage as part of the contractual terms of the credit card contract and credit card contracts that provide insurance coverage as a result of law or regulation (see paragraph 19 of this paper). In both cases, the effect of the insurance coverage would be accounted for separately from the credit card—ie in both cases, the insurance coverage would be excluded from the scope of IFRS 9. The accounting applying Approach B would also be consistent with circumstances in which the credit card and insurance coverage are two separate contracts.

Staff recommendation

32. On balance, the staff recommend Approach B. As explained previously in this paper, the staff think this approach achieves the objective of the proposal in the Exposure Draft, while addressing respondents’ concerns about the usefulness of the information that would be provided if entities were required to apply IFRS 9 to such credit card contracts in their entirety. In addition, it results in accounting for the credit card component that is

consistent with circumstances in which a credit card contract provides insurance coverage only as a result of law or regulation, and circumstances in which the credit card and insurance coverage are two separate contracts. Finally, it does not require the Board to reconsider, or override, any of the existing measurement requirements in IFRS 9.

Question 1 for Board members

Do you agree the Board should confirm the proposed scope exclusion from IFRS 17 for some credit card contracts that meet the definition of an insurance contract with some changes?

Specifically, an entity would be 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, the entity would be required to:

- (a) separate that insurance coverage component and apply IFRS 17 to it; and
- (b) apply other applicable IFRS Standards, such as IFRS 9, to the other components of the credit card contract.

Extending the proposals to ‘similar’ contracts

33. The Board developed the proposal for the credit card contracts discussed in paragraph 6 of this paper to address particular stakeholder concerns that, for some entities that apply accounting policies consistent with IFRS 9 or IAS 39 to credit card contracts that transfer significant insurance risk, the costs of applying IFRS 17 to such contracts might exceed the benefits of doing so (see paragraphs BC12–BC17 of the Basis for Conclusions on the Exposure Draft). As explained in paragraph BC17 of the Basis for Conclusions on the Exposure Draft, the Board considered whether it should limit the scope of the exclusion to credit card contracts with insurance coverage that the entity is obliged to provide (for example, because of law or regulation). However, the Board saw no reason to distinguish between credit card contracts depending on whether the entity is obliged, or chooses, to provide insurance coverage.
34. The staff agree with respondents’ suggestions that the Board consider extending the proposal to ‘similar’ contracts such as debit cards, charge cards, consumer financing contracts, current and deposit accounts and overdraft facilities. The staff think the Board’s rationale for proposing the scope exclusion from IFRS 17 for particular credit card contracts is relevant to, and arguably equally compelling for, other contracts that meet the definition of an insurance contract as long as 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.
35. Accordingly, the staff recommend the Board extend the scope of the amendment discussed in this paper to other contracts that provide credit or payment arrangements that are similar to credit card contracts 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 staff acknowledge that it is difficult to precisely describe what would be considered ‘similar’ to a credit card contract and indeed that population may change over time as payment arrangements evolve. However, the staff think that risk is mitigated by the fact that the population of the scope exclusion is limited by the requirement that the

entity must not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.⁵ In addition, the staff think the risk is further mitigated by the staff recommendation discussed in the previous section of this paper for the accounting for such contracts—ie to apply IFRS 17 to the insurance coverage component and to apply other applicable IFRS Standards to the other components of the contract.

36. Finally, as discussed in paragraph 13 of this paper, the staff note that some respondents expressed the view that the Board should limit the type of insurance coverage that is captured by the proposal—for example, the scope exclusion from IFRS 17 should apply only to contracts with insurance coverage that relates to indemnity for losses arising from the use of the credit card. When developing the Exposure Draft, the Board acknowledged that the proposal might capture credit card contracts with insurance coverage other than, or in addition to, coverage for supplier failure and observed that the considerations for the proposal would also be relevant to those contracts. The staff have not identified points the Board did not consider previously on this matter and therefore do not recommend a change in this regard.

Question 2 for Board members

Do you agree the Board should extend the amendment to other contracts that provide credit or payment arrangements that are similar to credit card contracts 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?

⁵ For the avoidance of doubt, the staff’s intention is that reinsurance contracts would not be captured by this amendment.

Appendix A—relevant extracts of the Basis for Conclusions on the Exposure Draft

Rationale for changing the requirements

- BC12 The definition of an insurance contract in IFRS 17 is unchanged from IFRS 4, and so the contracts described in paragraph BC9 already meet the definition of an insurance contract applying IFRS 4. However, IFRS 4 permits an entity to separate from a host insurance contract some non-insurance components and apply other IFRS Standards to the non-insurance components. IFRS 4 also allows a wide range of accounting practices for components that are not separated. As a result, some entities may be applying IFRS 9 or IAS 39 *Financial Instruments: Recognition and Measurement*, or an accounting policy similar to the requirements in those Standards, to such contracts. IFRS 17 is more restrictive on the separation of non-insurance components and is more specific in its requirements for accounting for all aspects of insurance contracts in their entirety. The Board was persuaded that for some entities that apply accounting policies consistent with IFRS 9 or IAS 39 to some credit card contracts and loan contracts that transfer significant insurance risk, the costs of applying IFRS 17 might exceed the benefits of changing to applying IFRS 17, as described in paragraphs BC13–BC22.

Proposed amendment to exclude from the scope of IFRS 17 specified credit card contracts that meet the definition of an insurance contract (paragraph 7(h))

- BC13 Some credit card contracts meet the definition of an insurance contract because the entity issuing the contracts provides insurance coverage as part of the overall package of benefits provided to the customer. An entity might provide such insurance coverage either because it is obliged to do so (for example, because of law or regulation), or because it chooses to do so (for example, as a fixed-price 'add-on'). If the entity acts as an agent in providing insurance coverage under such a contract, the contract is not an insurance contract issued by the entity. However, if the entity provides insurance coverage as a principal, the contract is an insurance contract issued by the entity.
- BC14 The Board considered whether an entity should apply IFRS 17 to such insurance contracts. IFRS 9 and IFRS 17 both have requirements that can address credit risk and insurance risk, which are prominent features of such credit cards. IFRS 9 is more focused on credit risk and IFRS 17 is more focused on insurance risk. The Board noted there is a balance between the usefulness of the information about such contracts that would be provided by applying IFRS 9 and the usefulness of the information about such contracts that would be provided by applying IFRS 17.

- BC15 When an entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer, the Board concluded that IFRS 9 would provide more useful information about those contracts. When the entity does reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer, the Board concluded that IFRS 17 would provide more useful information about those contracts. Hence, the Board decided that the Standard to be applied should not be a matter of choice. Furthermore, the Board has not been made aware of entities applying insurance contract accounting practices today to credit card contracts for which the entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer.
- BC16 Accordingly, the Board proposes a specific scope exclusion to reduce the operational burden for entities issuing credit card contracts for which the entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer. Doing so would address specific stakeholder concerns that some entities will need to implement and manage processes and systems for IFRS 17 only because they issue such credit card contracts. Excluding such contracts from the scope of IFRS 17 for these reasons would be similar to the rationale for providing the existing scope exclusion in paragraph 8 of IFRS 17 for fixed-fee service contracts. One of the criteria for the scope exclusion in paragraph 8 of IFRS 17 is that the entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer.
- BC17 The Board considered whether it should limit the scope of the exclusion to credit card contracts with insurance coverage that the entity is obliged to provide (for example, because of law or regulation). However, the Board saw no reason to distinguish between the credit card contracts described in paragraph BC13 depending on whether the entity is obliged, or chooses, to provide insurance coverage.

STAFF PAPER

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IASB® meeting

Project	Amendments to IFRS 17		
Paper topic	Transition—the prohibition from applying the risk mitigation option retrospectively		
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB® *Update*.

Purpose of the paper

1. This paper discusses staff analysis and recommendations about the feedback from respondents to the Exposure Draft *Amendments to IFRS 17* relating to the prohibition from applying the risk mitigation option retrospectively on transition to IFRS 17 *Insurance Contracts*. This paper follows the tentative decision of the International Accounting Standards Board (Board), at its November 2019 meeting, to consider further the feedback from outreach and comment letters on this topic.

Summary of staff recommendations

2. The staff recommend the Board retain, unchanged, the prohibition from applying the risk mitigation option retrospectively.

Structure of the paper

3. This paper provides:
 - (a) background on the topic;
 - (b) an overview of the feedback; and
 - (c) the staff analysis, recommendations and questions for Board members.

Background

4. The risk mitigation option in IFRS 17 permits an entity to recognise immediately in profit or loss some or all of the changes in the effect of financial risk on insurance contracts with direct participation features that usually adjust the contractual service margin. In other words, the risk mitigation option ‘switches off’ the variable fee approach to the extent that financial risk is mitigated.
5. To apply the risk mitigation option, an entity must have a previously documented risk-management objective and strategy for mitigating financial risk arising from the insurance contracts using derivatives or reinsurance contracts held¹ and, in applying that objective and strategy:
 - (a) the entity mitigates the financial risk arising from the insurance contracts using a derivative or a reinsurance contract held.²
 - (b) an economic offset exists between the insurance contracts and the derivative or reinsurance contract held, ie the values of the insurance contracts and the derivative or reinsurance contract held generally move in opposite directions because they respond in a similar way to the changes in the risk being mitigated. An entity does not consider accounting measurement differences in assessing the economic offset.
 - (c) credit risk does not dominate the economic offset.
6. IFRS 17 prohibits an entity from applying the risk mitigation option for periods before the date of initial application of IFRS 17. Consistent with the transition requirements for hedge accounting in IFRS 9 *Financial Instruments*, the Board concluded that retrospective application of the risk mitigation option in IFRS 17 would give rise to the risk of the use of hindsight.
7. When developing the Exposure Draft, the Board considered a suggestion from stakeholders to permit retrospective application of the risk mitigation option. In those

¹ The Board, at its December 2019 meeting, tentatively decided to finalise an amendment to IFRS 17 that would permit an entity to apply the risk mitigation option when it mitigates financial risk arising from insurance contracts with direct participation features using reinsurance contracts held.

² At a future meeting the Board will consider further feedback from respondents who suggested the Board extend the risk mitigation option to apply when an entity uses non-derivative financial instruments (see Agenda Paper 2D *Redeliberation Plan* of the November 2019 Board meeting).

stakeholders' view, retrospective application of the option would enhance comparability of information before and after the date of initial application of IFRS 17. However, the Board disagreed with that suggestion because permitting application of the option retrospectively would create opportunities for entities to decide the risk mitigation relationships to which to apply the option based on the known accounting outcome. Therefore, the credibility of information presented would be reduced.

8. The Board considered a suggestion by stakeholders to amend IFRS 17 to permit an entity to apply the risk mitigation option if, and only if, the entity applies the option for all risk mitigation relationships that would meet the conditions in paragraph B116 of IFRS 17. While in principle this would address the concern about applying the option based on a known accounting outcome, the Board concluded that such an amendment would not be appropriate because it would not be possible to assess the completeness of such an approach in practice. Historically, no other IFRS Standard has required an entity to document such risk mitigation relationships as specified in paragraph B116 of IFRS 17.
9. Despite concluding that an entity should not be permitted to apply the risk mitigation option retrospectively, the Board sought to address stakeholders' concerns by proposing in the Exposure Draft that an entity:
 - (a) apply the risk mitigation option for insurance contracts with direct participation features prospectively from the transition date, rather than the date of initial application. An entity would be required to designate risk mitigation relationships at or before the date it applies the option.
 - (b) be permitted to apply the fair value approach to a group of insurance contracts with direct participation features if it meets specified criteria relating to risk mitigation, even if it can apply IFRS 17 retrospectively to that group.

Feedback

10. Overall, respondents expressed support for the proposed amendments described in paragraph 9 of this paper. The Board tentatively decided to finalise those proposed amendments at its December 2019 meeting.³
11. Some respondents that commented on the proposed amendments also commented on the Board's decision to retain, unchanged, the requirements in IFRS 17 that prohibit an entity from applying the risk mitigation option retrospectively.
12. Some respondents continued to suggest the Board amend IFRS 17 to permit an entity to apply the risk mitigation option retrospectively, either in addition to, or instead of, the proposed amendments. In their view, the benefit of reflecting risk mitigation activities in the amounts recognised at transition in a consistent way with the accounting for risk mitigation activities after the transition date would outweigh the risk of the entity using hindsight to apply the option based on a known accounting outcome.
13. Some of those respondents noted that in their view:
 - (a) although the risk of the use of hindsight would exist, an entity's primary motive for applying the risk mitigation option retrospectively would be to reflect risk mitigation activities consistently before and after the transition date, rather than to achieve a specific desired result; and
 - (b) the requirements for applying the risk mitigation option provide sufficient conditions for permitting retrospective application of the option. IFRS 17 requires that:
 - (i) to apply the risk mitigation option, an entity must meet the conditions in paragraph B116 of IFRS 17 (see paragraph 5 of this paper); and
 - (ii) an entity would cease to apply the risk mitigation option for a risk mitigant if, and only if, the conditions in paragraph B116 of IFRS 17 cease to be met.

³ The Board's decision regarding the topic in this paper would not affect the Board's tentative decision to finalise the transition reliefs proposed in the Exposure Draft.

14. A small number of respondents suggested that, should the Board agree that it would be appropriate for an entity to apply the risk mitigation option retrospectively, the Board could reduce the risk of an entity using hindsight to apply the option based on a known accounting outcome. They suggested the Board could do this by reconsidering permitting an ‘all or nothing’ approach to applying the risk mitigation option retrospectively (see paragraph 8 of this paper).
15. Some of those respondents acknowledged the Board’s concern about the ability to assess the completeness of an ‘all or nothing’ approach in practice. However, those respondents expressed the view that an entity might have historical documentation of its overall risk-management objective and strategy prior to the date of transition to IFRS 17 that would meet the conditions in paragraph B116 of IFRS 17. In their view, that documentation would demonstrate completeness. Those respondents explained that an entity might hold such documentation for regulatory purposes or for internal purposes such as risk committee reporting.
16. Those respondents suggested that an entity be permitted to apply the risk mitigation option if, and only if, it applies the option to all risk mitigation relationships and the following conditions are met:
 - (a) documentation of an entity’s risk-management objective and strategy relating to risk mitigation relationships before the date of transition to IFRS 17 exists at the transition date; and
 - (b) the entity can prove with reasonable and supportable information that the conditions in paragraph B116 of IFRS 17 were met in the relevant past periods.
17. In contrast to the feedback described in paragraphs 12–16 of this paper, a small number of respondents, including three auditors, a regulator and a national standard-setter, agreed with the Board’s decision not to amend IFRS 17 to permit an entity to apply the risk mitigation option retrospectively. Two of those respondents expressed the view that the amendments proposed by the Board strike the right balance between preventing the use of hindsight and allowing entities an option to reflect risk mitigation activities in a consistent way before and after transition to IFRS 17.

Staff analysis and recommendations

18. The staff note that the amendments tentatively finalised by the Board, as described in paragraph 9 of this paper, would address stakeholder concerns that a contractual service margin at transition does not reflect risk mitigation activities from previous periods, as follows:
- (a) the amendment that would permit an entity to apply the option prospectively from the transition date rather than the initial application date would address concerns about inconsistency between the first reporting period applying IFRS 17 and the restated comparative information.
 - (b) the amendment that would permit an entity to apply the fair value approach for the groups of insurance contracts with risk mitigation relationships, even if an entity is able to apply IFRS 17 retrospectively, would result in any past gains or losses on derivatives and any effects of past changes in financial risk on the group of insurance contracts being reflected in opening retained earnings, thereby avoiding any accounting mismatches.
19. However, in the light of the feedback that continues to suggest the Board permit retrospective application of the risk mitigation option, the staff have further analysed whether the Board could allow a retrospective application of the risk mitigation option.
20. As explained in paragraphs 12–13 of this paper, some respondents continued to suggest the Board permit retrospective application of the risk mitigation option without adding any conditions beyond those required by paragraph B116 of IFRS 17. The staff note that, generally, those stakeholders disagreed with the Board’s cost-benefit analysis when comparing the risk of the use of hindsight to the benefit of reflecting risk mitigation activities before and after transition to IFRS 17 consistently.
21. Those respondents agreed that the risk of the use of hindsight would exist and did not suggest ways to reduce that risk. The staff note that applying paragraphs B115–B116 of IFRS 17 an entity chooses to apply the risk mitigation option on an individual derivative basis (or an individual reinsurance contract held basis). As such, without further constraint an entity could freely decide the extent to which to reflect risk mitigation activities in the contractual service margin based on a known accounting

outcome. Furthermore, the entity could do this in a way that would not reflect how the entity would have applied the option in previous periods, without hindsight, had it been applying IFRS 17.

22. In the Board’s view, permitting retrospective application of the risk mitigation option would come at a significant cost. The risk of the use of hindsight would affect the credibility of information presented on transition to IFRS 17 and in the subsequent periods in which those groups of insurance contracts continue to exist. Even if an entity applied the requirements retrospectively without using hindsight, it would be impossible for a user of financial statements to tell the difference between that entity and another which had used hindsight. The Board considered the costs and benefits when it decided not to propose an amendment to IFRS 17 to permit retrospective application of the risk mitigation option. The staff have not identified any new information for the Board to consider with regards to the costs and benefits.

Modified retrospective approach

23. Paragraph 114 of IFRS 17 requires an entity to provide disclosures which enable users of financial statements to identify the effect of groups of insurance contracts measured at the transition date applying the modified retrospective approach or the fair value approach on the contractual service margin and insurance revenue in the subsequent periods those insurance contracts continue to exist. In contrast, such disclosures are not required for groups of insurance contracts measured applying a full retrospective approach.
24. The staff considered whether, in response to feedback, the Board could permit retrospective application of the risk mitigation option only in the modified retrospective approach and not in the full retrospective approach. The risk of the use of hindsight would exist in the same way that it would exist in the full retrospective approach. However, the contractual service margin for those groups of insurance contracts (ie to which hindsight may have been applied in determining the contractual service margin at transition) would be ring-fenced and disclosed separately in all subsequent reporting periods those insurance contracts continue to exist.
25. In the staff view, disclosure of the contractual service margin to which hindsight may have been applied is not sufficient to address the Board’s concern about the risk of the

use of hindsight based on a known accounting outcome. Retrospective application of the risk mitigation option could have a significant impact on the amount of the contractual service margin at transition, and therefore on insurance revenue recognised in profit or loss in future reporting periods.

26. Disclosure would flag amounts that may have been determined using hindsight, but would not alleviate any doubt as to whether and how hindsight had or had not been applied.
27. Therefore, the staff think the Board should not amend IFRS 17 to permit retrospective application of the risk mitigation option—in either the full retrospective approach or the modified retrospective approach—without adding conditions beyond those required by paragraph B116 of IFRS 17.

All or nothing approach

28. As explained in paragraph 14 of this paper, a small number of respondents suggested the Board reconsider permitting an entity to apply an ‘all or nothing’ retrospective application of the risk mitigation option to reduce the risk of the use of hindsight.
29. The staff note that some of those respondents provided additional information about why they think any entity could reasonably ensure the completeness of such an approach. Specifically, those respondents noted that an entity may have historical risk-management objective and strategy documentation for purposes other than financial reporting.
30. The analysis in paragraphs 31–38 of this paper considers what an ‘all or nothing’ approach would require. The analysis is split as follows:
 - (a) what would ‘all’ mean in an ‘all or nothing’ approach?
 - (b) what documentation would be required?
 - (c) how would an entity apply the measurement requirements retrospectively?

What would ‘all’ mean in an ‘all or nothing’ approach?

31. In the staff view, it is necessary that ‘all’ is assessed at a reporting entity level. If it were assessed at a level lower than a reporting entity level (for example, at the level of a portfolio of insurance contracts or group of insurance contracts) the risk of the use

of hindsight would still exist, albeit that risk would be lower than it would be if the entity were permitted to apply the option retrospectively on an individual risk mitigation relationship basis.

32. Assume a group presents consolidated financial statements and has two subsidiaries. One subsidiary has the information required to apply an ‘all or nothing’ approach. The other subsidiary does not have the information require to apply an ‘all or nothing’ approach. The group as a whole would not meet the conditions to apply an ‘all or nothing’ approach in the consolidated financial statements.

33. In the staff view, it is necessary that ‘all’ mean all risk mitigation relationships that meet the criteria in paragraph B116 of IFRS 17 for all groups of insurance contracts with direct participation features that exist at the transition date. That includes all *past and current* derivatives and reinsurance contracts held that are at the transition date, or were in any previous reporting period, used to mitigate financial risks on those groups of insurance contracts.

34. The staff think that if ‘all’ were to mean only derivatives and reinsurance contracts held that exist at the transition date, risk mitigation activities prior to the transition date using derivatives or reinsurance contracts held that expired before the transition date would be reflected in the contractual service margin on transition inconsistently with risk mitigation activities that exist at the transition date. Therefore, stakeholder concerns about inconsistency in the treatment of risk mitigation activities would not be addressed.

What documentation would be required?

35. Some respondents expressed the view that an entity would already, for purposes other than IFRS 17, hold historical risk-management objective and strategy documentation that would meet the requirements in paragraph B116 of IFRS 17. In the staff view, to meet the requirements in paragraph B116 of IFRS 17 and to prove completeness for an ‘all or nothing’ approach that documentation, at a reporting entity level, must:
 - (a) specify all of the derivatives or reinsurance contracts held that are currently used, or have previously been used, to mitigate financial risks from all insurance contracts with direct participation features that exist at the transition date; and

- (b) specify the financial risks in the insurance contracts that are, or have previously been, mitigated using all of the derivatives and reinsurance contracts held identified in (a);
 - (c) demonstrate that an economic offset exists, or existed, between the insurance contracts and all of the derivatives and reinsurance contracts held identified in (a); and
 - (d) demonstrate that credit risk does not dominate the economic offset.
36. In the staff view, to apply the requirements in paragraphs B115–B116 of IFRS 17 retrospectively, that documentation must have existed at the beginning of the first reporting period that the entity would have met the conditions to apply the option in paragraph B115 of IFRS 17. Paragraph B116 of IFRS 17 requires that, to apply paragraph B115 of IFRS 17, an entity must have a *previously documented* risk-management objective and strategy. The staff think that, if the Board were to permit retrospective application on an ‘all or nothing’ basis, requiring documentation to exist at the transition date would not be sufficient because it would not ensure that the documentation existed in the relevant prior reporting periods. For example, if the transition date is 1 January 2021, documentation prepared on 31 December 2020 would not be sufficient evidence of a risk mitigation relationship that existed between 2017–2020.

How would an entity apply the measurement requirements retrospectively?

37. In addition to meeting all of the conditions discussed in paragraphs 31–36 of this paper, to apply the risk mitigation option retrospectively to all current and past risk mitigation relationships, an entity would also need to be able to measure all groups of insurance contracts with direct participation features that exist at the transition date retrospectively, including determining the effect of applying the option. In the staff view, the Board should not permit any reliefs or modifications for measuring the effect of applying the option in the full retrospective approach, because doing so would be inconsistent with that approach.
38. As a consequence, if an entity has used many derivatives to mitigate financial risks on many insurance contracts over a period of, say, 20 years prior to the transition date, the entity would be required to determine the effect of applying the risk mitigation

option for all of those derivatives. If there was one derivative for which the entity could not measure the effect, the entity would not meet the conditions of an ‘all or nothing’ approach. The entity would therefore be prohibited from applying the risk mitigation option to reflect any of the derivatives used in the 20-year period.

Overall staff view on ‘all or nothing’ approach

39. The staff think that applying an ‘all or nothing’ approach to retrospective application of the risk mitigation option, as set out in paragraphs 31–38 of this paper, would be impracticable in almost all cases. Meeting the conditions necessary to apply an ‘all or nothing’ approach would be a high hurdle that would likely be met in only a narrow set of circumstances. The staff think that amending IFRS 17 to permit an ‘all or nothing’ approach might risk implying that such an approach would address stakeholders’ concerns when in fact it would be unachievable in most cases.

Staff recommendation

40. Considering the analysis in paragraphs 18–39 of this paper, the staff recommend the Board retain, unchanged, the prohibition from applying the risk mitigation option retrospectively.

Question for Board members

Do you agree the Board should retain, unchanged, the prohibition from applying the risk mitigation option retrospectively?

STAFF PAPER

January 2020

IASB® meeting

Project	Amendments to IFRS 17		
Paper topic	Business combinations—contracts acquired in their settlement period		
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB® *Update*.

Purpose of the paper

1. This paper discusses staff analysis and recommendations about the feedback in response to the Exposure Draft *Amendments to IFRS 17* relating to contracts acquired in their settlement period. This paper follows the tentative decision of the International Accounting Standards Board (Board), at its November 2019 meeting, to consider further the feedback from outreach and comment letters on this topic.

Summary of staff recommendations

2. The staff recommend the Board retain, unchanged, the requirements in IFRS 17 *Insurance Contracts* for insurance contracts acquired in their settlement period in a transfer of insurance contracts that do not form a business or in a business combination within the scope of IFRS 3 *Business Combinations*.

Structure of the paper

3. This paper provides:
 - (a) background on the topic;
 - (b) an overview of the feedback; and
 - (c) the staff analysis, recommendations and questions for Board members.
4. The appendix to this paper provides examples of applying the definition of an insured event.

Background

IFRS 17 requirements

5. An entity is required to assess whether a contract meets the definition of an insurance contract, and therefore whether the contract is within the scope of IFRS 17, based on facts and circumstances at:
 - (a) inception of the contract if the entity issued the contract; or
 - (b) the date the contract is acquired if the entity acquired the contract.¹
6. An insurance contract is a contract under which the entity accepts significant insurance risk from the policyholder by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.
7. IFRS 17 defines an insured event as an uncertain future event covered by an insurance contract that creates insurance risk.
8. An entity classifies an insurance contract liability for an insured event as:
 - (a) a *liability for remaining coverage* if the insured event has not occurred; and
 - (b) a *liability for incurred claims* if the insured event has occurred.
9. The classification of an insurance contract liability as a *liability for incurred claims* or a *liability for remaining coverage* does not affect the determination of the fulfilment cash flows. However, the classification does affect the determination of the coverage period (ie the period over which the contractual service margin is recognised). Consequently, the classification affects whether some changes in the fulfilment cash flows adjust the contractual service margin and the allocation of the contractual service margin.
10. Some contracts, at inception or at the acquisition date, provide the policyholder with cover for events that have already occurred but the financial effect of which is still uncertain. Paragraph B5 of IFRS 17 specifies that such contracts meet the definition of an insurance contract because the insured event is the determination of the ultimate cost of claims. Applying IFRS 17 to such contracts, the insurance contract liability is

¹ In this paper ‘contracts acquired’ refers to contracts acquired in a transfer of insurance contracts that do not form a business or in a business combination within the scope of IFRS 3.

classified as a *liability for remaining coverage* until the date the ultimate cost of claims becomes known.

11. One example of such an insurance contract is a contract acquired by an entity after the occurrence of an event that triggered a valid claim by the policyholder but before the ultimate cost of the claim becomes known (referred to in this paper as ‘contracts acquired in their settlement period’).

Amendments to IFRS 17

12. When the Board considered proposing amendments to IFRS 17, it considered stakeholder concerns that applying IFRS 17 to contracts acquired in their settlement period would be a significant change from many existing insurance accounting practices. Applying many existing insurance accounting practices, the acquiring entity adopts the issuing entity’s:
 - (a) classification of the contract as an insurance contract based on facts and circumstances at inception of the contract; and
 - (b) classification as a *liability for incurred claims*, based on the insured event for the issuing entity.
13. As explained in paragraph BC207 of the Basis for Conclusions on the Exposure Draft, the Board:
 - (a) considered an amendment to IFRS 17 suggested by stakeholders that would exempt insurance contracts acquired in a business combination from the general requirements for the determination of the insured event; and
 - (b) disagreed with the stakeholders’ suggestion because, in the Board’s view, exempting insurance contracts acquired in a business combination from the general requirements for the determination of the insured event would create complexity for users of financial statements and reduce comparability with other transactions.
14. The Board, however, proposed reliefs on transition in response to stakeholder concerns that an entity may not have the information required to apply IFRS 17 retrospectively for insurance contracts acquired prior to the transition date. The proposed transition reliefs would permit an entity to classify a liability for insurance

contracts acquired in their settlement period prior to the transition date as a *liability for incurred claims* rather than a *liability for remaining coverage*. At its December 2019 meeting, the Board tentatively decided to finalise these proposed transition reliefs for contracts acquired.

Feedback

15. The Board did not ask a question on the requirements for business combinations in the Exposure Draft (other than relating to the proposed transition reliefs discussed in paragraph 14 of this paper and a proposed clarification to IFRS 3). Therefore, many respondents did not comment on those requirements.
16. A small number of respondents continued to express the view that determining the insured event for contracts acquired in their settlement period, as specified in paragraph B5 of IFRS 17,² is inconsistent with observations made by Transition Resource Group for IFRS 17 (TRG) members during a discussion about determining the insured event at the September 2018 TRG meeting. At that meeting, TRG members discussed two examples of insurance contracts issued (one that provides disability cover and one that provides fire cover) in which an insured event resulted in a claim with an uncertain settlement amount (of an annuity paid after a disability event and the cost of rebuilding a house after a fire event). TRG members observed that the definition of an insured event in IFRS 17 allows an entity to use judgement when determining whether the obligation to pay an annuity after a disability event and the obligation to pay the costs of rebuilding a house after a fire event are part of a *liability for remaining coverage* or a *liability for incurred claims* (see Appendix A to this paper).
17. Some respondents:
 - (a) suggested the Board amend IFRS 17 to permit in all circumstances an entity to classify a liability for insurance contracts acquired in their settlement period as a *liability for incurred claims*; and
 - (b) expressed the view that such an amendment would:

² See paragraph 10 of this paper.

- (i) improve the usefulness of information provided by IFRS 17 by increasing comparability between insurance contracts issued by an entity and insurance contracts acquired by an entity;
 - (ii) reduce complexity and costs because such an amendment would be consistent with many existing insurance accounting practices; and
 - (iii) particularly, reduce complexity and costs for entities that would be required to apply the general model, rather than the premium allocation approach, only as a result of the requirements for contracts acquired.
18. When insurance contracts are acquired, IFRS 17 requires an entity to calculate the contractual service margin as the difference between the consideration received or paid and the fulfilment cash flows at the acquisition date. Most respondents that suggested the Board permit an entity to classify a liability for insurance contracts acquired in their settlement period as a *liability for incurred claims* (ie as contracts with no contractual service margin) did not suggest an alternative accounting treatment for that difference. One respondent suggested the Board should require an entity to recognise the difference as a deferred liability—but not as a contractual service margin—and to amortise that amount on a systematic basis. That respondent suggested the amount amortised should be presented in profit or loss separately from the insurance service result—rather than be presented as part of insurance revenue as required by IFRS 17.
19. A small number of respondents suggested the Board introduce a business model approach in IFRS 17. In this approach, an entity would classify a liability for contracts acquired in their settlement period as a *liability for remaining coverage* or a *liability for incurred claims* depending on whether the entity acquired those contracts for the purpose of making a profit from adverse development cover or for a different purpose, for example, as part of a wider growth strategy. Those respondents expressed the view that such an approach would be consistent with the classification of financial assets applying IFRS 9 *Financial Instruments*.

20. Two accounting firms commented on determining the insured event for contracts acquired in their settlement period. Those firms agreed with the requirements in IFRS 17. However, one of those firms expressed concern about a lack of comparability between revenue recognised from insurance contracts acquired before the IFRS 17 transition date (to which a transition relief to classify as a *liability for incurred claims* may apply) and revenue recognised from insurance contracts acquired after the IFRS 17 transition date (to which the general requirements in IFRS 17 to classify as a *liability for remaining coverage* apply). That firm suggested the Board amend IFRS 17 to require an entity to present insurance revenue recognised from contracts acquired in their settlement period as a reduction in insurance service expenses.

Staff analysis and recommendations

21. The Board, at its November 2019 meeting, decided to consider further whether feedback on the determination of the insured event applying IFRS 17 could affect the decision the Board took previously to retain, unchanged, the requirements for contracts acquired in their settlement period. The staff analysis in this paper considers separately:
- (a) the definition of an insured event.
 - (b) the effects of respondents' suggestions to amend IFRS 17 on:
 - (i) the measurement of insurance contracts acquired in their settlement period; and
 - (ii) presentation in profit or loss.
 - (c) other feedback:
 - (i) entities that apply the premium allocation approach; and
 - (ii) suggested business model approach.

Applying the definitions in IFRS 17

22. The definition of an insured event is fundamental to IFRS 17. A contract meets the definition of an insurance contract—and therefore is in the scope of IFRS 17—if, and only if, there is an insured event.³ In addition, whether the insured event has occurred determines whether an insurance contract liability meets the definition of a *liability for remaining coverage* or a *liability for incurred claims*.
23. As explained in paragraph 16 of this paper, a small number of respondents continued to express the view that determining the insured event for insurance contracts acquired in their settlement period, as specified in paragraph B5 of IFRS 17, is inconsistent with observations made by TRG members during a discussion about determining the insured event for two examples of insurance contracts issued. Appendix A to this paper demonstrates how the definition of an insured event is applied:
- (a) in the two examples of insurance contracts issued discussed at the September 2018 TRG meeting; and
 - (b) to insurance contracts acquired in their settlement period.
24. The staff observe that paragraph B5 of IFRS 17 does not prescribe specific requirements for determining the insured event in insurance contracts acquired in their settlement period. Instead, that paragraph simply explains how the general requirements for determining the insured event apply to some contracts.
25. Consequently, if the Board were to amend IFRS 17 to require an entity to classify contracts acquired in their settlement period as a *liability for incurred claims*, the Board would need to create an exception to the definition of an insured event. That exception would specify that for contracts acquired in their settlement period the insured event could be a known past event, rather than an uncertain future event. A consequence of that exception would be that an acquired contract could meet the definition of an insurance contract even though the entity does not identify itself as providing insurance coverage (ie cover for a specified uncertain future event).

³ An entity shall also apply IFRS 17 to investment contracts with discretionary participation features it issues, provided the entity also issues insurance contracts.

26. In the staff view, any amendment that would change or create an exception to the definition of an insured event would be a fundamental change to the principles of IFRS 17. It would therefore not meet the criteria for amendments to IFRS 17 set by the Board. Nevertheless, paragraphs 27–34 of this paper set out the effects on measurement and presentation in profit or loss if the Board were to create an exception to the definition of an insured event for contracts acquired in their settlement period.

Measurement of contracts acquired in their settlement period

27. Applying IFRS 17 to insurance contracts acquired, the contractual service margin is calculated as the difference between the consideration received or paid and the fulfilment cash flows. If IFRS 17 were amended as suggested by some respondents, there would be no contractual service margin for contracts acquired in their settlement period. As such, the Board would need to add requirements to IFRS 17 to specify the accounting treatment for the difference between the consideration received or paid and the fulfilment cash flows.
28. One respondent suggested that the Board should require an entity to recognise the difference as a deferred liability—but not as a contractual service margin—and to amortise that amount on a systematic basis.
29. The contractual service margin requirements already provide a mechanism to account for the difference between the consideration and the fulfilment cash flows. The staff acknowledge that recognising a contractual service margin for insurance contracts acquired in their settlement period may add operational complexity for entities compared to some existing insurance accounting practices. However, in the staff view, creating a new alternative requirement to the contractual service margin requirements for entities in some circumstances—such as introducing a new ‘deferred liability’—would add unnecessary complexity to the requirements of IFRS 17.

Presentation in profit or loss

30. Applying IFRS 17, the insurance revenue recognised from insurance contracts acquired in their settlement period would equal the consideration the entity receives on the acquisition. This is consistent with the general principle in IFRS 17 that total

insurance revenue equals the consideration for the contracts (premiums for insurance contracts issued). The following example demonstrates the presentation in profit or loss applying IFRS 17.

31. An entity acquires an insurance contract in its settlement period. At the acquisition date, claim amounts are uncertain, expected claims are CU300⁴ and the risk adjustment for non-financial risk is CU50. The consideration received is CU370.
32. Applying IFRS 17, the contractual service margin is determined as CU20 (CU370 – CU350). Assuming events occur as expected, the following amounts would be recognised in profit or loss:

Insurance revenue [CU300 + CU50 + CU20]	370
Insurance service expenses [-CU300]	(300)
Insurance service result	70

33. If IFRS 17 were amended as suggested by some respondents and the insurance contract classified as a *liability for incurred claims*, there would be no insurance coverage and therefore no insurance revenue. Assuming events occur as expected, the following amounts would be recognised in profit or loss:

Insurance revenue	-
Insurance service expenses [CU50]	50
Insurance service result	50
Amortisation of deferred liability [CU20]	20
Profit or loss	70

34. In the staff view, reflecting the consideration received by the acquiring entity in insurance revenue provides useful information for users of financial statements that is consistent with the information provided by IFRS 17 for insurance contracts issued by the entity. The staff are not persuaded by the view that the alternative presentation in

⁴ In this paper amounts are expressed in currency units (CU).

paragraph 33 of this paper would provide more useful information to users of financial statements.

Present insurance revenue as a reduction in insurance service expenses (suggestion in paragraph 20 of this paper)

35. Using the example in paragraphs 31–32 of this paper, the following illustration demonstrates the suggestion by one respondent to present insurance revenue recognised on contracts acquired in their settlement period as a reduction in insurance service expenses:

Insurance revenue	-
Insurance service expenses [CU300 + CU50 + CU20 - CU300]	70
Insurance service result	70

36. In the staff view, recognising insurance revenue on insurance contracts acquired in their settlement period as a reduction in insurance service expenses as set out in paragraph 35 of this paper would:
- (a) reduce comparability between profits earned on insurance contracts issued and profits earned on insurance contracts acquired; and
 - (b) add unnecessary complexity to the presentation requirements.
37. The staff acknowledge concerns from one respondent that the proposed transition reliefs for insurance contracts acquired in their settlement period will reduce comparability between insurance revenue recognised from insurance contracts acquired before and after the IFRS 17 transition date. However, the staff note that:
- (a) reduced comparability between transactions that occurred before and after a transition date is a common consequence of providing reliefs on transition to a new or amended IFRS Standard;
 - (b) transition reliefs are necessary when an entity does not have the information required to apply requirements retrospectively; and

- (c) IFRS 17 requires an entity to provide disclosures in periods after transition that enable users of financial statements to identify the effect on the contractual service margin and insurance revenue from groups of insurance contracts measured at the transition date applying the modified retrospective approach or the fair value approach.
38. The staff view is that the benefit of maintaining comparability between insurance revenue recognised from insurance contracts *issued* and insurance contracts *acquired* after the transition date is greater than would be the benefit of maintaining comparability between insurance revenue recognised from insurance contracts acquired *before* and *after* the transition date.
39. Therefore, the staff think the Board should retain, unchanged, the presentation requirements for insurance revenue recognised on insurance contracts acquired in their settlement period.

Analysis of other feedback

Premium allocation approach

40. Some respondents expressed particular concern about the cost and complexity of recognising a contractual service margin for insurance contracts acquired for entities that would otherwise account for all their contracts applying the premium allocation approach, ie entities issuing short-term contracts eligible for the premium allocation approach. Because there is no contractual service margin applying the premium allocation approach, such entities may need to develop systems to apply the general model solely to account for contracts acquired in their settlement period.
41. The staff note that an entity acquiring an insurance contract in its settlement period—a period which could last many years—is in a different position compared to an entity issuing a short-term insurance contract with a small probability of a claim occurring. If the claim settlement period is expected to last many years, the acquirer has essentially entered into a long-term insurance contract.
42. Consider an example. Entity A issues an insurance contract that provides coverage in the event of a cargo ship sinking in a specified year. The probability that the ship will sink is 1/100,000. If the ship sinks, it could take 10 years to determine the ultimate

cost of claims for losses the policyholder incurs as a result of the sinking event.

Entity A could determine:

- (a) the insured event is the uncertain occurrence of the ship sinking, and therefore the coverage period is one year; or
- (b) the insured events are the uncertain occurrence of the ship sinking and the determination of the ultimate cost of claims for the losses the policyholder incurs as a result of the sinking event, and therefore the coverage period could be up to 11 years.

43. Now assume that the ship sinks and, subsequently, Entity A is acquired by Entity B. Entity B has acquired an insurance contract knowing that there will be a large uncertain claim amount. Accordingly, at the time Entity B assumes the obligation, that entity is in a fundamentally different position than Entity A was when it issued the insurance contract with only a 1/100,000 probability of a claim occurring at all. For Entity B, there is no judgement required to determine the service that the entity is providing—it is providing insurance coverage for the uncertainty in the amount of claims.
44. In the staff view, requiring Entity B to account for such a contract applying the general model will provide useful information to users of financial statements about the contract Entity B has entered into based on facts and circumstances at the acquisition date.

Business model approach (suggestion in paragraph 19 of this paper)

45. As explained in paragraph 19 of this paper, some respondents suggested the Board add requirements to IFRS 17 to differentiate the accounting treatment of insurance contracts acquired in their settlement period depending on whether the entity acquired those contracts for the purpose of making a profit from adverse development cover or for a different purpose, for example, as part of a wider growth strategy. The staff think that adding such requirements would add unnecessary complexity to the Standard. The requirements in IFRS 17 measure any profit expected to be earned by the entity regardless of the entity's intention.

46. In addition, the staff disagree with some respondents' view that adding such requirements would be consistent with the role of the business model in the classification of financial assets in IFRS 9.
47. The business model test in IFRS 9 is not based on the intention of the entity but is an assessment of fact. As a result of the business model assessment, the classification of financial assets in IFRS 9 is based (in part) on the manner in which an asset contributes cash flows to an entity. This is consistent with paragraph 6.49(b) of the *Conceptual Framework for Financial Reporting* which states that the relevance of information provided by a measurement basis is affected by how the asset or liability contributes to future cash flows. Thus, the business model test in IFRS 9 considers how an entity manages its financial assets to generate cash flows (in particular, whether that is by collecting contractual cash flows on the financial assets and/or through their sale).
48. In contrast, respondents suggesting a business model approach to determine the accounting for an acquisition of insurance contracts have suggested that a distinction be drawn based on the *reason for the acquisition*. Thus, unlike the business model test in IFRS 9, the focus would not be on the manner in which the liability contributes to future cash flows. Those respondents suggested, for example, different accounting for an entity that acquires insurance contracts for the purpose of making a profit from adverse development cover and one that makes the acquisition for the purpose of increasing the size of their portfolio—even if in both cases the entity will hold those contracts and pay claims.
49. Furthermore, the suggestion that a form of business model test should be determinative in the classification of these acquired insurance contracts is inconsistent with IFRS 9. The business model test in IFRS 9 is not in itself the basis for classification of financial assets—the classification also depends on the nature of the contractual cash flows.

Staff recommendation

50. In the staff view, the Board’s conclusion in developing the Exposure Draft—that exempting insurance contracts acquired in their settlement period from the general requirements for determining the insured event would create complexity for users of financial statements and reduce comparability with the requirements for other transactions—continues to hold.
51. The staff recommend the Board retain, unchanged, the requirements in IFRS 17 for insurance contracts acquired in their settlement period in a transfer of insurance contracts that do not form a business or in a business combination within the scope of IFRS 3.

Question for Board members

Do you agree the Board should retain, unchanged, the requirements in IFRS 17 for insurance contracts acquired in their settlement period in a transfer of insurance contracts that do not form a business or in a business combination within the scope of IFRS 3?

Appendix A—applying the definition of an insured event

- A1. This appendix demonstrates how the definition of an insured event is applied:
- (a) in the two examples of insurance contracts issued discussed at the September 2018 TRG meeting; and
 - (b) to insurance contracts acquired in their settlement period.
- A2. IFRS 17 defines an insured event as an uncertain future event covered by an insurance contract that creates insurance risk.

Two examples discussed at the TRG meeting

- A3. At the September 2018 TRG meeting, TRG members considered an implementation question which asked whether, for two specified examples, an insurance contract liability would be classified as a *liability for remaining coverage* (for insured events that have not yet occurred) or a *liability for incurred claims* (for insured events that have already occurred).

Disability cover

- A4. The first example considered by TRG members was an insurance contract issued that requires an entity to pay an annuity after a disability event. TRG members observed that, for that example, the entity could determine that:
- (a) the insured event is the uncertain event of the policyholder becoming disabled because of the occurrence of an accident/illness; or
 - (b) the insured events are:
 - (i) the uncertain event of the policyholder becoming disabled because of the occurrence of an accident/illness (ie the event that triggers valid claims); and
 - (ii) the uncertain event of the policyholder remaining disabled and eligible to claim (ie the determination of the ultimate cost of those claims).

Fire cover

- A5. The second example considered by TRG members was an insurance contract issued that requires an entity to pay to the policyholder the costs of rebuilding a house after a

fire event. TRG members observed that, for that example, the entity could determine that:

- (a) the insured event is the uncertain occurrence of a fire; or
- (b) the insured events are:
 - (i) the uncertain occurrence of a fire (ie the event that triggers valid claims); and
 - (ii) the uncertain costs of rebuilding the house damaged by a fire (ie the determination of the ultimate cost of those claims).

A6. The staff observe that in both examples considered by TRG members, the event that triggers a valid claim (ie the policyholder becoming disabled or the occurrence of a fire) meets the definition of an insured event. Therefore, the contracts meet the definition of an insurance contract irrespective of whether the entity assesses that the determination of the ultimate cost of claims is an insured event.

Contracts acquired in their settlement period

A7. An event that occurred before a contract was acquired by an entity cannot be an insured event for the entity because at the acquisition date there is no uncertainty as to the occurrence of that event. Accordingly, in contrast to the two examples considered by TRG members, for contracts acquired in their settlement period there is only one event that could be an insured event for the acquirer—the determination of the ultimate cost of claims.

A8. Therefore, for contracts acquired in their settlement period:

- (a) if claims amounts are uncertain at the acquisition date, there is an insured event and the contract would meet the definition of an insurance contract.
- (b) if claims amounts are known at the acquisition date, there is no insured event and the contract would not meet the definition of an insurance contract.

Amounts payable to policyholders of those contracts would be accounted for as a financial liability applying IFRS 9.

STAFF PAPER

January 2020

IASB® meeting

Project	Amendments to IFRS 17		
Paper topic	Interim financial statements		
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (Board) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB® *Update*.

Purpose of the paper

1. This paper discusses staff analysis and recommendations about the requirement relating to interim financial statements in IFRS 17 *Insurance Contracts*.
2. When developing the Exposure Draft *Amendments to IFRS 17*, the International Accounting Standards Board (Board) considered the concerns and challenges raised by stakeholders about this requirement. The Board concluded there was no compelling reason to make a change. Consequently, the Board decided to retain the requirement unchanged.
3. This paper follows the tentative decision of the Board, at its November 2019 meeting, to consider further the feedback from outreach and comment letters on this requirement.

Summary of staff recommendations

4. The staff recommend the Board amend the requirement relating to interim financial statements in paragraph B137 of IFRS 17 to require an entity to:
 - (a) make an accounting policy choice as to whether to 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; and
 - (b) apply its choice of accounting policy to all insurance contracts issued and reinsurance contracts held (ie accounting policy choice at entity level).

Structure of the paper

5. This paper provides:
 - (a) background information, including an overview of the requirement in IFRS 17 relating to interim financial statements, the Board's rationale for setting that requirement and the Board's previous discussion of concerns and challenges raised about this requirement;
 - (b) an overview of the feedback on the Exposure Draft; and
 - (c) the staff analysis, recommendations and questions for Board members.
6. This paper includes the following appendices:
 - (a) Appendix A—overview of the assessment of the approaches suggested by respondents against the criteria the Board applied when developing the Exposure Draft; and
 - (b) Appendix B—overview of the assessment of the likely effects of the approaches suggested by respondents compared to the requirements in IFRS 17 as issued in May 2017.

Background

IFRS 17 requirements

7. IAS 34 *Interim Financial Reporting* states that the frequency of an entity's reporting should not affect the measurement of its annual results. However, paragraph B137 of 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.
8. IFRS 17 generally requires changes in estimates of the fulfilment cash flows (ie changes related to future periods) to adjust the contractual service margin, whereas experience adjustments (ie differences between expected and actual amounts in the current and past period) are recognised in profit or loss immediately—thus the accounting depends on the timing of a reporting date, as demonstrated in the following example.
9. Consider two entities:
 - (a) Entity A prepares annual financial statements and quarterly interim financial statements applying IAS 34; and
 - (b) Entity B prepares annual financial statements only.
10. At the beginning of Year 1, Entity A and Entity B issue the same two-year insurance contract with a premium of CU100,¹ expected claims of CU50 and a contractual service margin of CU50.² In the fourth quarter of Year 1, Entity A and Entity B change their expectations and now expect an additional amount of claims of CU30 to be incurred in Year 2. The contractual service margin of the contract, which is allocated based on coverage units on a straight-line basis, is adjusted accordingly. Applying the requirement in paragraph B137 of IFRS 17, at the end of Year 1, gives the outcomes summarised in the following table.

¹ In this paper amounts are denominated in 'currency units' (CU).

² The example ignores the risk adjustment for non-financial risk and discounting for simplicity.

Applying paragraph B137 of IFRS 17 (period-to-period basis)³						
Contractual service margin (CSM) recognised in profit or loss	Q1	Q2	Q3	Q4	Year 1	Remaining CSM end of Year 1
Entity A (quarterly reporting as defined in IAS 34)	6.25	6.25	6.25	0.25	19.0	1.0
Entity B (annual reporting)					10.0	10.0

11. Assume Entity B is a subsidiary of Entity A. Entity A may require Entity B to provide internal interim reports because Entity A produces consolidated group interim financial statements applying IAS 34. The internal interim reports are not interim financial statements applying IAS 34 from the perspective of the subsidiary, so Entity B would need to maintain accounting estimates for these reports separately from the accounting estimates needed for its individual financial statements prepared using IFRS Standards. Accordingly, Entity B would need to maintain:
- (a) a set of accounting estimates for internal interim reports; and
 - (b) a set of accounting estimates for its annual financial statements.

Board's rationale

12. The Board developed the requirement in paragraph B137 of IFRS 17 in response to stakeholder feedback that recalculating the carrying amount of the contractual service margin annually when the entity has prepared interim financial statements applying IAS 34 would be a significant practical burden because of the different treatments of changes in estimates and experience adjustments.
13. As explained in paragraph BC236 of the Basis for Conclusions on IFRS 17, requiring the contractual service margin to be adjusted for changes in estimates of the fulfilment

³ Entity A has a remaining contractual service margin of CU1 (CU50 – CU6.25 x 3 – CU30 – CU0.25). This is because, in Year 1, Entity A recognises in profit or loss a contractual service margin of: (i) CU6.25 in each of the first three quarters (CU50 / 8 quarters); and (ii) CU0.25 in the last quarter ((CU50 – CU6.25 x 3 – CU30) / 5 quarters). Entity B has a remaining contractual service margin of CU10 (CU50 – CU30 – CU10). This is because, in Year 1, Entity B recognises in profit or loss a contractual service margin of CU10 ((CU50 – CU30) / 2 years).

cash flows but not for experience adjustments has the consequence that the accounting depends on the timing of a reporting date.⁴ To avoid entities thinking they need to recalculate amounts previously reported in interim financial statements, the Board decided that IFRS 17 should specifically prohibit entities from changing 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.

Board’s previous discussion of concerns and challenges raised

14. When the Board considered proposing amendments to IFRS 17, it considered stakeholders’ concerns and challenges about the requirement relating to interim financial statements in paragraph B137 of IFRS 17 and the suggestions from stakeholders to address those concerns and challenges. Specifically, as explained in paragraphs BC215–BC216 of the Basis for Conclusions on the Exposure Draft:
 - (a) some stakeholders suggested the Board amend IFRS 17 to expand paragraph B137 of IFRS 17 so that it applies to accounting estimates made in all interim reports whether or not IAS 34 is applied, to avoid the need to keep two sets of accounting estimates; and
 - (b) other stakeholders suggested the Board not expand paragraph B137 of IFRS 17 but permit, rather than require, its application.

15. The Board disagreed with those stakeholders’ suggestions because those suggestions would add complexity for both preparers and users of financial statements, and would reduce comparability between entities. This is because:
 - (a) entities might develop different definitions of an interim report if they were permitted to use interim reports other than those addressed by IAS 34. The Board noted that entities may prepare interim reports other than those addressed by IAS 34, for example, an internal management report, for a variety of purposes.

⁴ Appendix A of IFRS 17 defines an experience adjustment as ‘a difference between: (a) for premium receipts (and any related cash flows such as insurance acquisition cash flows and insurance premium taxes)—the estimate *at the beginning of the period* of the amounts expected in the period and the actual cash flows in the period; or (b) for insurance service expenses (excluding insurance acquisition expenses)—the estimate at the beginning of the period of the amounts expected to be incurred in the period and the actual amounts incurred in the period.’

- (b) entities might treat accounting estimates made in previous interim financial statements in different ways to each other if they were permitted rather than required to apply paragraph B137 of IFRS 17.
16. Accordingly, the Board decided to retain the requirement relating to interim financial statements in paragraph B137 of IFRS 17 unchanged.

Feedback on the Exposure Draft

17. Some respondents from each region, including about half of the preparers and preparer representative bodies, commented on the requirement relating to interim financial statements in IFRS 17.
18. Most of those respondents expressed concerns about the application of the requirement as follows:
- (a) some respondents noted that the requirement in paragraph B137 of IFRS 17 results in two identical entities with identical estimates of fulfilment cash flows and the same economic and non-economic factors reporting a different contractual service margin depending on the frequency of their external financial reporting, as discussed in paragraphs 9–10 of this paper. Accordingly, those respondents expressed the view that IFRS 17 does not currently ensure comparability between entities with different reporting frequency.
 - (b) some respondents think that the requirement in paragraph B137 of IFRS 17 results in a more significant practical burden than the burden discussed in paragraph 13 of this paper that the requirement is supposed to alleviate. Those respondents expressed the view that the practical burden would be more significant for entities in a consolidated group, as discussed in paragraph 11 of this paper.
 - (c) some respondents noted that the requirement in paragraph B137 of IFRS 17 results in a fundamental change to existing insurance accounting practices for entities that currently use a year-to-date basis in interim financial statements—ie for entities that currently reverse in a subsequent interim

period or annual reporting period the effect of estimates and changes in estimates made in a prior interim period. Those respondents regard the retention of paragraph B137 in IFRS 17 as a major challenge in implementation processes causing unnecessary complexity and costs.

- (d) other respondents said that the requirement in paragraph B137 of IFRS 17 does not result in useful information given that, applying existing insurance accounting practices, many entities do not fully update actuarial assumptions at interim periods for the purpose of applying IAS 34. Those stakeholders expressed the view that an entity should be permitted to change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in the annual reporting period to more accurately reflect changes in estimates and experience adjustments referring to the annual reporting period.

19. To address the concerns discussed in paragraph 18 of this paper, respondents suggested the Board amend IFRS 17 as follows:

- (a) some respondents suggested deleting paragraph B137 of IFRS 17.
- (b) some respondents continued to suggest amending IFRS 17 to permit, rather than require, the application of the requirement in paragraph B137 of IFRS 17, consistent with the suggestion made during the development of the Exposure Draft that the Board considered and rejected.
- (c) a small number of respondents suggested amending IFRS 17 so that a subsidiary that does not prepare interim financial reports as defined in IAS 34 is permitted to account for insurance contracts issued and reinsurance contracts held on the basis of the frequency of reporting of its parent entity (ie the frequency of reporting at the consolidated level).

20. Other respondents did not express a preference on how to address the concerns discussed in paragraph 18 of this paper but expressed a view that, if the Board were to amend paragraph B137 of IFRS 17, the Board's objective should be to avoid the need for entities in a consolidated group to keep two sets of accounting estimates.

21. A small number of respondents agreed with the Board’s decision not to expand paragraph B137 of IFRS 17 so that it applies to accounting estimates made in all interim reports whether or not IAS 34 is applied (see paragraphs 14–16 of this paper).
22. Two national-standard setters, who would support deleting paragraph B137 of IFRS 17, expressed the view that the approach taken by the Board in developing paragraph B137 of IFRS 17 is similar to the approach taken in IFRIC 10 *Interim Financial Reporting and Impairment*. IFRIC 10 addresses an apparent conflict between the following requirements in IAS 34:
 - (a) an entity should apply the same accounting policies in its interim financial statements as it applies in its annual financial statements.
 - (b) the frequency of an entity’s reporting (annual, half-yearly or quarterly) should not affect the measurement of its annual results. To achieve that objective, measurements for interim reporting purposes should be made on a year-to-date basis. This might suggest that an entity should reverse in a subsequent interim period an impairment loss it recognised in a prior interim period, whereas IAS 36 *Impairment of Assets* states that an impairment loss recognised for goodwill should not be reversed in a subsequent period. IFRIC 10 states that an entity should not reverse an impairment loss recognised in a previous interim period in respect of goodwill.
23. One of those national-standard setters suggested that if the Board retains, unchanged, the requirement in paragraph B137 of IFRS 17, the Board should:
 - (a) provide a more comprehensive rationale for its decision in the Basis for Conclusions on IFRS 17; and
 - (b) initiate a Post-implementation Review of IAS 34 so that the Board could use feedback to make an informed decision about the future course of interim reporting.
24. A small number of respondents said they would not support the deletion of paragraph B137 of IFRS 17.
25. A small number of respondents questioned the interaction between the requirement in paragraph B137 of IFRS 17 and the annual cohort requirement in paragraph 22 of

IFRS 17. Those respondents questioned whether an entity that reports half-yearly would be prohibited from including in the same group contracts issued more than six months apart (rather than a year), considering that paragraph B137 of 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.

Staff analysis and recommendations

26. As discussed at the November 2019 Board meeting, the staff have identified from the feedback from outreach and comment letters additional information about the balance between the cost and benefits of the requirement in paragraph B137 of IFRS 17. The staff analysis in this paper considers whether this additional information could affect the decision the Board took previously for the requirement relating to interim financial statements in IFRS 17.
27. The staff note that the feedback discussed in paragraph 18 of this paper highlights two main sources of costs for the implementation and application of the requirement in paragraph B137 of IFRS 17. They are the need to:
 - (a) maintain two sets of accounting estimates; and
 - (b) change existing insurance accounting practices for interim financial statements (from a year-to-date basis to a period-to-period basis).
28. Although some respondents commented on the requirement in paragraph B137 of IFRS 17, the staff note that the Board did not include a question about this requirement in the Exposure Draft. Therefore, the staff performed additional outreach to gather additional stakeholders' feedback on possible ways of amending IFRS 17 to ease IFRS 17 implementation and application, without significantly reducing the usefulness of information for users of financial statements relative to that which would otherwise result from applying paragraph B137 of IFRS 17.

29. The staff have:
- (a) considered the following approaches suggested by stakeholders as discussed in paragraph 19 of this paper:
 - (i) Approach 1—Deleting paragraph B137 of IFRS 17;
 - (ii) Approach 2—Introducing an accounting policy choice; and
 - (iii) Approach 3—Permitting a subsidiary to account for its insurance contracts on the basis of the frequency of reporting at the consolidated level.
 - (b) assessed those approaches against the criteria the Board applied when developing the Exposure Draft. The Board decided that any amendments to IFRS 17 must not:
 - (i) change the fundamental principles of the Standard because that would result in a significant loss of useful information for users of financial statements relative to that which would otherwise result from applying IFRS 17;
 - (ii) unduly disrupt implementation already underway; or
 - (iii) further delay the effective date of IFRS 17.
 - (c) considered the likely effects of the suggested approaches compared to the requirements in IFRS 17 as issued in May 2017.
30. The staff note the feedback from respondents discussed in paragraph 18(d) of this paper that, applying existing insurance accounting practices, many entities do not fully update actuarial assumptions at interim periods for the purpose of applying IAS 34 and, therefore, in the view of those respondents, entities should be permitted to change the treatment of accounting estimates made in interim financial statements when applying IFRS 17 in the annual reporting period to more accurately reflect changes in estimates and experience adjustments referring to the annual reporting period. However, the staff note that none of the possible amendments to paragraph B137 of IFRS 17 discussed in this paper (including deleting paragraph B137 of IFRS 17) would in and of itself change the IFRS 17 requirement to update estimates and assumptions at interim reporting dates.

Approach 1—Deleting paragraph B137 of IFRS 17

31. As discussed in paragraph 19(a) of this paper, some respondents suggested deleting paragraph B137 of IFRS 17 so that an entity is not prohibited from changing 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.
32. However, the staff note that:
- (a) a small number of respondents said they would not support the deletion of paragraph B137 of IFRS 17, as discussed in paragraph 24 of this paper;
 - (b) one additional stakeholder informed the staff it would not support the deletion of paragraph B137 of IFRS 17 because this stakeholder thinks the application of paragraph B137 of IFRS 17 provides the most useful information; and
 - (c) stakeholders that support the requirement in paragraph B137 of IFRS 17 might not have commented on this requirement, given that the Board did not include a question about this requirement in the Exposure Draft.
33. The staff think that if paragraph B137 of IFRS 17 were deleted, new questions might arise about whether or not entities could 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.
34. Accordingly, the staff think that deleting paragraph B137 of IFRS 17 might unduly disrupt implementation for entities that might need to revisit the work they have already done to develop systems and processes to comply with the requirement in paragraph B137 of IFRS 17.
35. The staff think that such disruption could be minimised if the Board were to allow an optional approach for the treatment of accounting estimates in interim financial statements.

Approach 2—Introducing an accounting policy choice

36. As discussed in paragraph 19(b) of this paper, some respondents continued to suggest amending IFRS 17 to permit, rather than require, the application of the requirement in paragraph B137 of IFRS 17.
37. As discussed in paragraph 14(b) of this paper, the Board considered this suggestion when developing the Exposure Draft. The Board disagreed with the suggestion because it would result in different entities treating accounting estimates made in previous interim financial statements differently. This in turn would:
- (a) add complexity for both preparers and users of financial statements.
 - (b) reduce comparability between entities. If applying the requirement in paragraph B137 of IFRS 17 was an option, an entity might decide whether or not to use the option considering:
 - (i) its reporting frequency compared to the reporting frequency of all or some of its competitors;
 - (ii) which option is less burdensome from a practical perspective;
 - or
 - (iii) a combination of both of these factors.
38. The staff think that the Board’s view discussed in paragraph 37 of this paper continues to hold.
39. However, the staff:
- (a) agree with some respondents that requiring the application of paragraph B137 of IFRS 17 does not ensure comparability between entities with different frequency of reporting, as illustrated in the example in paragraphs 9–10 of this paper;
 - (b) note the feedback from some respondents discussed in paragraph 18(b) of this paper that, for some entities, the requirement in paragraph B137 of IFRS 17 results in a more significant practical burden than the burden that the Board intended to alleviate; and

- (c) note that the practical burden of applying the requirements in IFRS 17 is more significant for entities that report quarterly compared to entities that report half-yearly, because of the need to determine the carrying amount of the contractual service margin and the amounts recognised in profit or loss more frequently.
40. The staff think that permitting an entity to choose whether to 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 would enable the entity to assess what is less burdensome from a practical perspective between:
- (a) maintaining two sets of accounting estimates for entities within a consolidated group with different frequency of reporting; and
 - (b) recalculating the carrying amount of the contractual service margin and the amounts recognised in profit or loss for a subsequent reporting period.
41. In the staff view, introducing such a choice:
- (a) would ease IFRS 17 implementation by reducing implementation costs for many entities; and
 - (b) would not unduly impair comparability between entities if an entity were to apply consistently the same approach for all insurance contracts issued and reinsurance contracts held. This is particularly the case given that different frequency of reporting already gives rise to differences in outcomes even when all entities are required to apply paragraph B137 of IFRS 17.
42. Discussions with some users of financial statements suggest that the additional complexity of introducing an accounting policy choice as defined in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* related to interim financial statements of entities issuing insurance contracts could be regarded as acceptable when balanced against the cost relief for those entities.⁵

⁵ IAS 8 defines accounting policies as ‘the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.’

43. Applying IAS 8, an entity is required to:
- (a) select and apply accounting policies consistently for similar transactions, other events and conditions.
 - (b) change an accounting policy only if the change:
 - (i) is required by an IFRS Standard; or
 - (ii) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.
 - (c) disclose the nature of a change in accounting policies and the reasons why applying the new accounting policy provides reliable and more relevant information.

Approach 3—Permitting a subsidiary to account for its insurance contracts on the basis of the frequency of reporting at the consolidated level

44. As discussed in paragraph 19(c) of this paper, a small number of respondents suggested amending IFRS 17 so that a subsidiary that does not prepare interim financial reports as defined in IAS 34 is permitted to account for insurance contracts issued and reinsurance contracts held on the basis of the frequency of reporting at the consolidated level. This suggestion would allow a subsidiary to apply paragraph B137 of IFRS 17 quarterly if its parent entity prepares consolidated group interim financial statements applying IAS 34 quarterly.
45. As discussed in paragraphs 14(a) of this paper, when developing the Exposure Draft, the Board considered a suggestion similar to the suggestion discussed in paragraph 44 of this paper that would extend the requirement in paragraph B137 of IFRS 17 to any type of reporting that is not defined elsewhere in IFRS Standards. The Board disagreed with that suggestion because it would result in different entities developing different definitions of an interim report. This in turn would:
- (a) add complexity for both preparers and users of financial statements; and
 - (b) reduce comparability between entities.

46. Similarly, the staff think that permitting a subsidiary to account for insurance contracts issued and reinsurance contracts held on the basis of the frequency of reporting at the consolidated level would add complexity for both preparers and users of financial statements and would reduce comparability between entities. In addition, such an approach would still involve changes for entities that currently use a year-to-date basis for their interim financial statements and therefore would not significantly reduce IFRS 17 implementation and application costs for some entities.
47. The staff note that, as mentioned by some accounting firms during outreach, internal reports prepared by a subsidiary for consolidated purposes might differ from the subsidiary's financial statements for reasons other than the requirement in paragraph B137 of IFRS 17, for example for intercompany transactions and business combinations. Therefore, entities that are subsidiaries might need to maintain two sets of accounting estimates even if the Board were to amend IFRS 17 to permit a subsidiary to account for insurance contracts issued and reinsurance contracts held on the basis of the frequency of reporting at the consolidated level.
48. Accordingly, the staff think that permitting a subsidiary to account for insurance contracts issued and reinsurance contracts held on the basis of the frequency of reporting at the consolidated level would not address respondents' concerns about IFRS 17 implementation and application costs discussed in paragraph 27 of this paper.

Staff recommendation

49. On balance, the staff recommend the Board amend the requirement relating to interim financial statements in IFRS 17 to require an entity to:
- (a) make an accounting policy choice as to whether to 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; and
 - (b) apply its choice of accounting policy to all insurance contracts issued and reinsurance contracts held (ie accounting policy choice at entity level).

50. Regarding the feedback from respondents discussed in paragraph 25 of this paper, the staff note that paragraph 28 of IFRS 17 (reflecting the proposed minor amendments in the Exposure Draft) provides requirements for adding insurance contracts to a group of insurance contracts and states that insurance contracts issued may be added to a group over a period that crosses more than one reporting period. For example, an entity may have a January–December annual reporting period and may group insurance contracts issued between July–June. The frequency of reporting does not restrict the grouping requirements in paragraphs 14–22 of IFRS 17. Therefore, the staff think the Board does not need to clarify that the application of the requirement in paragraph B137 of IFRS 17 does not affect the application of the annual cohort requirement in paragraph 22 of IFRS 17.

Question for Board members

Do you agree the Board should amend the requirement relating to interim financial statements in IFRS 17 to require an entity to:

- (a) make an accounting policy choice as to whether to 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; and
- (b) apply its choice of accounting policy to all insurance contracts issued and reinsurance contracts held (ie accounting policy choice at entity level)?

Appendix A—overview of the assessment of the approaches suggested by respondents against the criteria the Board applied when developing the Exposure Draft

A1. The following table provides an overview of the assessment of the approaches suggested by respondents and discussed in this paper against the criteria the Board applied when developing the Exposure Draft.

Approach	(a) Would the suggested approach change the fundamental principles of IFRS 17 resulting in a significant loss of useful information for users of financial statements relative to that which would otherwise result from applying IFRS 17?	(b) Would the suggested approach unduly disrupt implementation processes already under way or risk undue delays in the effective date of IFRS 17?
1—Deleting paragraph B137 of IFRS 17	No—The staff think that deleting paragraph B137 of IFRS 17 would not result in a significant loss of useful information for users of financial statements. Paragraph B137 of IFRS 17 was introduced to reduce costs for entities applying IFRS 17.	Yes—The staff think that deleting paragraph B137 of IFRS 17 might unduly disrupt implementation for entities that might need to revisit the work they have already done to develop systems and processes to comply with the requirement in paragraph B137 of IFRS 17.
2—Introducing an accounting policy choice	No—The staff think that introducing an accounting policy choice would not result in a significant loss of useful information for users of financial statements if an entity were to apply consistently the same approach to all insurance contracts issued and reinsurance contracts held. This is particularly the case given that different frequency of reporting already gives rise to differences in outcomes even when all entities are required to apply paragraph B137 of IFRS 17.	No—The staff think that introducing an accounting policy choice would not unduly disrupt implementation. If an entity prefers the entity could still apply paragraph B137 of IFRS 17.

Approach	(a) Would the suggested approach change the fundamental principles of IFRS 17 resulting in a significant loss of useful information for users of financial statements relative to that which would otherwise result from applying IFRS 17?	(b) Would the suggested approach unduly disrupt implementation processes already under way or risk undue delays in the effective date of IFRS 17?
<p>3— Permitting a subsidiary to account for its insurance contracts on the basis of the frequency of reporting at the consolidated level</p>	<p>No—The staff think that permitting a subsidiary to account for insurance contracts issued and reinsurance contracts held on the basis of the frequency of reporting at the consolidated level would not result in a significant loss of useful information for users of financial statements. However, this approach would not address respondents’ concerns about IFRS 17 implementation and application costs resulting from the need to change existing insurance accounting practices for interim financial statements and the possible need to maintain two sets of accounting estimates for reasons other than the requirement in paragraph B137 of IFRS 17.</p>	<p>No—The staff think that permitting a subsidiary to account for insurance contracts issued and reinsurance contracts held on the basis of the frequency of reporting at the consolidated level would not disrupt implementation. This approach would extend the application of an existing requirement of IFRS 17 to a larger set of interim reports.</p>

Appendix B—overview of the assessment of the likely effects of the approaches suggested by respondents compared to the requirements in IFRS 17 as issued in May 2017

B1. The following table provides an overview of the assessment of the likely effects of the approaches suggested by respondents and discussed in this paper compared to the requirements in IFRS 17 as issued in May 2017.

Approach	Financial statements effects	Cost-benefit analysis
1—Deleting paragraph B137 of IFRS 17	Deleting paragraph B137 of IFRS 17: (a) might result in entities recalculating amounts previously reported in interim financial statements in subsequent interim periods and for the annual reporting period; and (b) would not affect the financial statements of entities that do not produce interim financial statements applying IAS 34.	Deleting paragraph B137 of IFRS 17 might result in a significant practical burden for entities that report more frequently than annually, because of the recalculation of the carrying amount of the contractual service margin and the amounts recognised in profit or loss.

Approach	Financial statements effects	Cost-benefit analysis
<p>2— Introducing an accounting policy choice</p>	<p>Introducing an accounting policy choice would result in different entities applying different accounting policies. An entity would either change or 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.</p>	<p>The staff think that introducing an accounting policy choice would ease IFRS 17 implementation by reducing implementation costs. An entity would assess what is less burdensome from a practical perspective between:</p> <ul style="list-style-type: none"> (a) maintaining two sets of accounting estimates for entities within a consolidated group with different frequency of reporting; and (b) recalculating the carrying amount of the contractual service margin and the amounts recognised in profit or loss for a subsequent reporting period. <p>The staff think that the additional complexity of introducing an accounting policy choice related to interim financial statements of entities issuing insurance contracts could be regarded as acceptable when balanced against the cost relief for those entities.</p>
<p>3— Permitting a subsidiary to account for its insurance contracts on the basis of the frequency of reporting at the consolidated level</p>	<p>Permitting a subsidiary to account for insurance contracts issued and reinsurance contracts held on the basis of the frequency of reporting at the consolidated level would permit subsidiaries to align the measurement of those contracts in their statutory financial statements and in the consolidated financial statement of their parent entity.</p>	<p>Permitting a subsidiary to account for insurance contracts issued and reinsurance contracts held on the basis of the frequency of reporting at the consolidated level would add complexity for both preparers and users of financial statements and would reduce comparability between entities. In addition, such an approach would still involve changes for entities that currently use a year-to-date basis for their interim financial statements and therefore would not significantly reduce IFRS 17 implementation and application costs for some entities.</p>