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The discussion continues on concerns related to transition and scope of IFRS 17

IASB proposes scope exclusion election for certain loans and transition exception for acquired claim liabilities

At a glance

On 7 February 2019 the IASB continued its discussions on the concerns and implementation challenges arising from IFRS 17 and proposed two further amendments to the Standard to:

- permit an entity to elect to apply IFRS 9 in its entirety rather than IFRS 17 to contracts for which the only insurance risk in the contract is the settlement of some or all of the obligation created by the contract (e.g. death waivers in loan obligations). However, the discussion did not cover insurance risk embedded in credit cards, which is being separately evaluated and will be discussed at a future meeting.
- on transition, under the modified retrospective approach, require an entity to classify a liability that relates to the settlement of claims incurred before an insurance contract was acquired as a liability for incurred claims. This modification would only be permitted to the extent the entity does not have reasonable and supportable information to apply a retrospective approach. For entities applying the fair value approach the Board agreed to propose an amendment that would allow entities to choose classification as a liability for incurred claims.

The Board agreed to retain the transition requirement that prohibits retrospective application of the risk mitigation option under the variable fee approach. It was noted that permitting retrospective application involved the use of hindsight and could give rise to ‘cherry picking’ opportunities. However, the Board acknowledged that the concerns raised by stakeholders are valid, and welcomed a discussion at a future meeting of alternative solutions to this issue that the staff are currently exploring.

For the remaining transition issues the Board agreed to retain the current requirements.

The Staff plans to bring papers on the remaining implementation concerns and challenges to the March 2019 meeting, along with potential sweep issues. The Board will also at a future meeting consider the package of all the proposed amendments to ensure they comply with the criteria the Board agreed in October 2018 and will consider the need for additional disclosures as a consequence of the proposed amendments. An exposure draft is still expected around the end of June 2019.

The views in this In transition are based on our observations from the 7 February 2019 meeting, and they might differ in some respects from the official report of the meeting that will be published by the IASB in IASB Update at a later date

Background

1. In connection with the issuance of IFRS 17, the IASB established a transition resource working group ('TRG') to provide a public forum for stakeholders to follow the discussion of questions raised on implementation of the new standard. The purpose of the TRG is to facilitate a public discussion to provide support for stakeholders, and information to the Board, on implementation questions arising from the application of IFRS 17.
2. Since the issuance of the standard, IASB staff have also been engaged in a variety of activities with stakeholders to follow the implementation of IFRS 17. At the IASB meeting on 24 October, the Board agreed to explore potential amendments to IFRS 17 based on a list of implementation issues and concerns compiled by the staff. The Board noted that the criteria set a high hurdle for change, and any amendments suggested would need to be narrow in scope and deliberated quickly to avoid significant delays in the effective date.
3. The IASB has held several meetings discussing the reported concerns and implementation challenges to date, and we have summarised the proposed amendments to date, including those addressed as annual improvements in June 2018, towards the end of this publication.

Overview of items discussed during the February IASB Board meeting

4. In its 7 February 2019 meeting the Board evaluated whether six concerns and implementation challenges dealing with scope and transition would meet the criteria for amending the standard. The table below summarises the decisions reached relating to these six issues. For two of the topics, elements of the issues are expected to be discussed further at a future meeting.

<i>Staff paper</i>	<i>Concerns and implementation challenges</i>	<i>IASB Decision</i>
Loans that transfer significant insurance risk (Staff paper 2A)	Scope of IFRS 17 for loans with insurance risk	Amend*
Transition—Optionality and comparative information (Staff paper 2B)	Optionality in transition approaches	Not amend
	Comparative information on transition	Not amend
Transition—Risk mitigation option and amounts accumulated in other comprehensive income on transition (Staff paper 2C)	Prohibition of retrospective application of the risk mitigation option under the variable fee approach	Not amend*
	Cumulative amounts included in other comprehensive income on transition	Not amend
Transition—Modified retrospective approach (Staff paper 2D)	Requirements in the modified retrospective approach (including where similar issues arise for the fair value approach)	Partly amend

* Elements of this issue will be brought back for further discussions.

Loans that transfer significant insurance risk

5. The IASB agreed to propose an amendment to IFRS 17 to introduce an election to apply IFRS 9 in its entirety rather than IFRS 17 to contracts for which the only insurance risk in the contract is the settlement of some or all of the obligation created by the contract. An example is a bank that provides a loan to a customer where repayment of the remaining loan is waived in the event of the debtor's death. The staff had suggested that the entity be required to make the IFRS 9 election on a contract by contract basis. However, after some discussion, Board members suggested instead that the election should be done at the portfolio level, perhaps using the IFRS 17 definition of portfolio. It was clarified that an entity's decision should be described as an election rather than as an accounting policy choice, as the latter would require consistent application at the consolidated group level whereas the former would allow for different elections for different operations within an entity that would not need to be conformed on consolidation.

6. The Board believes that this amendment would satisfy stakeholders' concerns relating to various products, including those issued by banks, where there is embedded insurance cover within a loan or other obligation. Examples include mortgages with death waivers, equity release/reverse mortgages, and student loan contracts whose repayment is income contingent.

7. Although the definition of insurance contracts within the scope of IFRS 17 is mainly unchanged from IFRS 4, the requirements for unbundling of components within an insurance contract are more restrictive under IFRS 17. The Staff noted that this discussion and proposed amendment is not meant to cover contracts beyond those listed in the paper; hence insurance cover embedded in certain credit card contracts is being considered separately by the staff and will be brought to the Board in a future meeting.

8. One Board member proposed that if the IFRS 9 election is made, there should be a requirement that the financial instrument be measured at fair value through profit or loss. However, several Board members noted that if an entity elects to account for such contracts under IFRS 9, the SPPI test (i.e. test to determine if instrument pays solely principal plus interest) is considered to be a robust test for classification of loans and other obligations in this standard and they were reluctant to impose any further requirements. That is, to the extent an instrument is determined to fail the SPPI test, measurement at fair value through profit or loss would be required.

9. Although some Board members suggested that additional disclosures should be required if IFRS 9 is elected, a Board member noted that IFRS 9 disclosures are sufficient and adequately address disclosures for complex financial instruments. In addition, the staff noted that the need for additional disclosures as a consequence of all amendments to IFRS 17 will be addressed by the Board at a later stage.

10. The approach taken by the staff to neither propose an amendment to the definition of insurance contracts nor amend IFRS 17 principles on separation of investment components was welcomed by the Board. The Board also agreed with this being an election, acknowledging that this would enable entities that mainly write insurance contracts to account for them under IFRS 17, while allowing other entities that mainly issue financial instruments, such as banks, to apply IFRS 9.

Optionality and comparative information on transition

Optionality included in the transition requirements

11. The IASB agreed to retain the current requirements in IFRS 17 to allow entities to select either the modified retrospective approach or the fair value approach on transition provided that it is impracticable to apply IFRS 17 retrospectively.

12. One Board member acknowledged the concern raised that a choice of transition method could reduce comparability between entities, and that this lack of comparability could be ongoing for several years subsequent to transition. However, the Board agreed with the staff analysis that while an amendment could increase comparability, such an amendment might unduly disrupt ongoing implementation projects. The staff paper notes that stakeholders believe that the disclosure requirements would potentially mitigate some of the reported concerns.

The requirement to present comparative information for prior reporting periods

13. All Board members agreed that IFRS 17 should not be amended to allow an option not to restate comparative information at transition, despite this being permitted when IFRS 9 is adopted. The Board noted that the stakeholder suggestion to not require comparatives was raised as a relief to meet the 1 January 2021 effective date requirement, but given the proposed decision to in the Board meeting in November 2018 to defer the effective date by one year, this concern seems to be addressed.

14. Stakeholders also expressed concern that permitting entities to not restate the comparative information on financial assets when IFRS 9 is adopted, whilst requiring restatement for comparative information under IFRS 17 would cause an accounting mismatch. However, during the discussion several Board members emphasised that an entity can avoid this mismatch by choosing to restate IFRS 9 figures as well, assuming they can do so without using hindsight.

15. A few Board members also noted that the starting point in adopting IFRS 17 is significantly different from the starting point for IFRS 9 transition, since IFRS 9 adopters were all previously applying the same requirements (IAS 39). In contrast, IFRS 17 introduces fundamental changes to the accounting for insurance contracts, which are pervasive to insurers' financial statements, and the prior accounting under IFRS 4 was subject to a wide variety of accounting practices. Allowing no restatement of comparatives under IFRS 17 would significantly increase complexity in the financial statements, and thus not meet the criteria for amendment.

Transitional requirements for the risk mitigation option and amounts accumulated in other comprehensive income

Prohibition of retrospective application of the risk mitigation option

16. The Board agreed to retain the transition requirement that prohibits retrospective application of the risk mitigation option under the variable fee approach ('VFA'). It was noted that permitting retrospective application may involve the use of hindsight and could give rise to 'cherry picking' opportunities. However, the Board acknowledged that the concerns addressed by stakeholders on transition are valid, and welcomed a discussion at a future meeting of alternative solutions to this issue that the staff are currently exploring.

17. As background to the above, the staff noted that when entities use derivatives to mitigate financial risks inherent in VFA contracts, the effect of the derivative is included in profit or loss, whilst the effects on the insurance contracts would normally (absent an onerous contract situation) adjust contractual service margin ('CSM'). Entities that apply the risk mitigation option under VFA can choose to not include the effects of changes in financial assumptions in the adjustment of the CSM if certain criteria are met.

18. Stakeholders have raised concerns that at transition, this risk mitigation option is available only on a prospective basis, resulting in potential misstatement of the CSM on transition (as past risk mitigation activity is not reflected) and consequent misstatement of future profit, potentially for many years. Some have suggested that entities should be allowed to apply this election either retrospectively or at least prospectively from the transition date (rather than prospectively from the date of initial application of IFRS 17).

19. Some noted that for any approach, documentation of the previous risk mitigation strategy and objectives would be essential, but acknowledged that the real difficulty would be in deciding which relationships the risk mitigation option would have applied to in previous periods and the extent of the risk mitigation covered by the option. This differs from the IFRS 9 designated fair value option; once the fair value designation in IFRS 9 is selected, there is no choice about how the resulting measurement applies retrospectively.

20. Some Board members expressed sympathy for the suggestion of applying the risk mitigation option prospectively from the transition date, and noted that this would increase the comparability on transition and was interrelated with the previous discussion on comparatives. Others suggested that expanding the option by only one year would not solve the problem, given that the cumulative impact of prior periods' risk mitigation could be substantial. Although the Board voted for prohibiting retrospective application of the risk mitigation option, they left open the possibility of other solutions, to be discussed at a future meeting.

Determination of the cumulative amount of insurance finance income or expenses recognised in other comprehensive income ('OCI') on transition

21. All IASB members agreed to retain the current requirements that permit or require entities that have selected the OCI option to set the cumulative amount recognised in OCI at nil at the transition date to the extent that the entities do not have reasonable and supportable information to apply a retrospective approach (or when entities hold the underlying items under the VFA).

22. Stakeholders have raised concerns that setting the accumulated amount in OCI to nil at transition whilst not similarly setting to nil the amount accumulated in OCI for the related assets, distorts equity on transition and the recognition of future investment margin. They have therefore suggested that entities that do not have reasonable and supportable information to apply this retrospectively should be allowed to deem the cumulative amount in OCI related to corresponding assets as nil at transition to IFRS 17. An alternative suggestion is to permit the accumulated amount in OCI for insurance contracts on transition to be the same amount as the accumulated amount in OCI on the assets. Some Board members noted that this question is interrelated with the retrospective application of the risk mitigation option, and consistent with this decision the Board decided to retain the existing requirements.

Transition - Modified retrospective approach

23. All Board members agreed to propose adding a specified modification to the modified retrospective approach to require an entity to classify a liability that relates to the settlement of claims incurred before an insurance contract was acquired as a liability for incurred claims. This modification would only be permitted to the extent the entity does not have reasonable and supportable information to apply a retrospective approach. When the fair value approach is applied, the Board agreed to propose to amend the standard to allow a choice to classify such liabilities as incurred claims. The Board decision was in response to stakeholders who noted that in portfolio transfers and some business combinations, the contracts are managed in the same system as those that have been issued by the entity, making it impractical to distinguish claims arising from contracts they have issued from those that they have been acquired.

24. The Board also agreed to the following with regard to the modified retrospective approach:

- retain the existing IFRS 17 requirements on transition related to reasonable and supportable information that an entity:
 - cannot use a specified modification to the extent the entity has reasonable and supportable information to apply the requirement retrospectively;

- can only use a specified modification when the entity has reasonable and supportable information to apply that modification;
- not amend IFRS 17 to allow an entity to use/develop its own modifications;
- not amend the modification related to the use of cash flows that are known to have occurred instead of estimating retrospectively cash flows that were expected to occur, and;
- not amend IFRS 17 to permit an entity to apply the specified modifications related to groups of insurance under the general model to determine the CSM for groups of contracts under the VFA.

25. Board members noted that the modifications allowed on transition are restricted to meet the objective of developing a transitional approach that is a reasonable approximation of retrospective transition. Allowing further modifications to this model would contradict this objective. However, as some stakeholders have found the requirements challenging, Board members suggested that it could clarify certain requirements. Entities are not prohibited from making necessary estimates in both retrospective application and when applying a specified modification in the modified retrospective approach. For example, if data on actual cash flows has not been collected or has been collected at a different level than required, an entity is required to use reasonable and supportable information to estimate those amounts. A Board member suggested that the staff prepare additional educational material beyond the chart appended to the staff papers to clarify the transition requirements.

Overview of total proposed amendments to date

26. The Board has proposed the following amendments related to IFRS 17 to date:

<i>Area</i>	<i>Meeting</i>	<i>Proposed amendment</i>
Scope	February 2019	Scope of certain loans.
Initial recognition	June 2018	Clarify terminology in paragraph 28 of IFRS 17.
Insurance Acquisition cash flows	June 2018	Clarify paragraph 27 to include those relating to contracts issued and 'expected to be issued'.
	January 2019	Amend requirements for acquisition cash flows related to anticipated future renewals outside the contract boundary (and related amendments).
Risk adjustment for non-financial risk	June 2018	Clarify words related to risk adjustment to avoid the risk of double accounting.
Contractual Service Margin	June 2018	Clarify coverage period for contracts with direct participating features.
	January 2019	Amortisation of the contractual service margin for contracts under the general model that include an investment return service (and related amendments).
Reinsurance Contracts held	January 2019	Recognise a gain on reinsurance held when recognising a loss on onerous underlying insurance contracts that are covered by reinsurance contracts held that cover losses on a proportionate basis (and related amendments).
	January 2019	Risk mitigation exemption expanded to reinsurance held for insurance contracts with direct participation features.
Presentation of Insurance contracts	December 2018	Separate presentation of portfolios of assets and portfolios of liabilities.
Disclosures	June 2018	Clarify wording in the sensitivity analysis disclosure.
Effective date	November 2018	1 year deferral of effective date of IFRS 17 to 1 January 2022.
	November 2018	Temporary exemption to IFRS 9 extended to 1 January 2022.

Business Combinations	June 2018	Consequential amendment to IFRS 3 to be applied prospectively.
	June 2018	Exclusion of business combinations under common control in IFRS 17 requirements.
	February 2019	Classification of claims incurred acquired prior to transition under the modified retrospective approach and fair value approach.
Other proposed amendments	June 2018	Revise wording in IFRS 9, IFRS 7 and IAS 32 to achieve intended scope of these standards and IFRS 17.
	June 2018	Update IASB illustrative Example 9 in IFRS 17 with an explanation.

Future expected discussions

27. The Board noted that discussions on the remaining implementation challenges and concerns will continue in the March 2019 Board meeting. The Staff propose to bring back a summary of all suggested amendments and assess the total package of amendments against the criteria previously agreed to and consider the need for any amendments in the disclosures as a consequence of the proposed amendments.

28. In its papers for the October 2018 Board meeting the IASB staff presented 25 identified implementation challenges. The majority of these concerns are now addressed and the staff has noted that remaining matters will to be brought back to a future meeting;

- level of aggregation, including effects on transition;
- further analysis of the risk mitigation exception; and
- scope for credit cards with an embedded insurance component.

Next steps

29. The Board will follow due process by issuing an exposure draft that is expected to be issued around the end of the first half of 2019, allowing an appropriate public comment period, and redeliberating responses for any proposed amendments. The expected timeframe for issuance of final amendments proposed to date, considering the due process required, is normally 12 to 18 months.

PwC has developed the following publications and resources related to IFRS 17, 'Insurance Contracts':

- [In transition INT2019-01: IASB proposes to further amend IFRS 17](#)
- [In transition INT2018-07: IASB agrees to propose limited changes to balance sheet presentation of insurance contract assets and liabilities](#)
- [In transition INT2018-06: IASB proposes to amend the effective date of IFRS 17 and extend the temporary exemption of IFRS 9 for insurers](#)
- [In transition INT2018-05: IASB agrees on criteria for evaluating any potential future amendments to IFRS 17](#)
- [In transition INT2018-04: TRG debates more IFRS 17 implementation issues](#)
- [In transition INT2018-03: Amendments to IFRS 17 on the IASB Board agenda](#)
- [In transition INT 2018-02: Insurance TRG addresses unit of account, contract boundary, and coverage unit issues](#)
- [In transition INT2018-01: Insurance TRG holds its first meeting on IFRS 17](#)
- [In brief INT2017-05: IFRS 17 marks a new epoch for insurance contracts](#)
- [In depth INT2017-04: IFRS 17 marks a new epoch for insurance contract accounting](#)
- [Using Solvency II to implement IFRS 17](#)
- [IFRS 17 – Redefining insurance accounting](#)

PwC clients who would like to obtain any of these publications, or have questions about this In transition, should contact their engagement partner.

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