Staff paper

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IASB® meeting

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Project	**Rate-regulated Activities**
Topic	**Scope—Interaction with IFRS 17**
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Objective

1. This paper sets out staff analysis and recommendations on whether the scope of the final Accounting Standard should exclude regulatory assets and regulatory liabilities that might arise when premiums charged in insurance contracts within the scope of IFRS 17 *Insurance Contracts* are regulated.

Staff recommendation

2. We recommend that the final Accounting Standard exclude regulatory assets and regulatory liabilities that might arise when premiums charged in insurance contracts within the scope of IFRS 17 are regulated.

Structure of the paper

3. This paper is structured as follows:
   (a) proposals in the Exposure Draft *Regulatory Assets and Regulatory Liabilities* (Exposure Draft) (paragraphs 4–7);
   (b) feedback (paragraphs 8–22); and
   (c) staff analysis (paragraphs 23–33).

Proposals in the Exposure Draft

4. Paragraph 3 of the Exposure Draft proposes that an entity applies the [draft] Standard to all its regulatory assets and all its regulatory liabilities. The Exposure Draft does not provide any scope exclusion.

5. Paragraph 6 of the Exposure Draft specifies that a regulatory asset or a regulatory liability can exist only if:

   (a) an entity is party to a regulatory agreement;

   (b) the regulatory agreement determines the regulated rate the entity charges for the goods or services it supplies to customers; and

   (c) part of the total allowed compensation for goods or services supplied in one period is charged to customers through the regulated rates for goods or services supplied in a different period.

6. The Exposure Draft defines regulatory agreement as 'a set of enforceable rights and obligations that determine a regulated rate to be applied in contracts with customers.' Paragraph 8 of the Exposure Draft says that a regulatory agreement may take the form of a contractual licensing agreement, a service concession arrangement, or a set of rights and obligations specified by statute, legislation or regulations.

7. Paragraph 6(c) of the Exposure Draft states that for a regulatory asset or a regulatory liability to exist there needs to be a difference in timing. Paragraph 15 of the Exposure Draft says that differences in timing arise when the amount of revenue recognised in a period:

   (a) does not include all of the total allowed compensation for the goods or services supplied in that period, because part of that total allowed compensation was already included in revenue in the past, or will be included in revenue in the future; or

   (b) includes amounts that provide part of the total allowed compensation for goods or services supplied in a different period (past or future).

Feedback

8. This section is structured as follows:

   (a) feedback from respondents to the Exposure Draft (paragraphs 9–12); and

   (b) targeted outreach (paragraphs 13–22).

Feedback from respondents to the Exposure Draft

9. Many respondents expressed concerns that the proposed scope may be broader than intended—that is, they said the scope proposals are not sufficiently clear to help them determine whether a regulatory agreement is in the scope of the Exposure Draft in specific circumstances.

10. A few respondents said that these concerns are partly caused by a lack of clarity about whether the proposed model is intended to provide information that supplements *only* the information provided by applying IFRS 15 *Revenue from Contracts with Customers* or whether it is also intended to supplement the requirements of other IFRS Accounting Standards—for example IFRS 17.

11. A few respondents highlighted there are some situations in which the premiums charged in insurance contracts are regulated. Some of these respondents said it is not clear whether the proposals in the Exposure Draft are intended to apply to such insurance contracts, while others thought that the proposals in the Exposure Draft should not apply because IFRS 17 is applicable to such insurance contracts. Respondents in the latter group thought the final Standard should clarify that an entity should apply other IFRS Accounting Standards first and then apply the requirements of the final Standard to any remaining rights and obligations to determine if the entity has regulatory assets or regulatory liabilities.[1]

[1] We note that this view is aligned with a tentative decision made by the IASB at its meeting in September 2022. At that meeting, the IASB tentatively decided that the final Standard would clarify the intended interaction between the Standard and IFRIC 12 *Service Concession Arrangements*. That is, an entity would apply IFRIC 12 first and then apply the requirements of the Standard to any remaining rights and obligations to determine if the entity has regulatory assets or regulatory liabilities. See IASB Update here.

12. A few national standard-setters in Asia-Oceania, North America and Europe and a body of preparers in the insurance industry in Asia-Oceania recommended a scope exclusion for insurance contracts that have premiums that are regulated. Some of these respondents said that it would be preferable to exclude insurance contracts from the scope rather than requiring entities to analyse the existence of any regulatory assets or regulatory liabilities that would need to be recognised. According to these respondents a scope exclusion would provide clarity and ease concerns about the scope of the model being too broad.

Targeted outreach

13. We contacted a few respondents to the Exposure Draft and four accounting firms to gather evidence about:

    (a) the existence of insurance contracts within the scope of IFRS 17 that might give rise to regulatory assets or regulatory liabilities; and

    (b) how widespread these insurance contracts might be and how material the regulatory assets or regulatory liabilities might be.

14. This section describes examples identified by either respondents to the Exposure Draft or by stakeholders we spoke to subsequently. We have not analysed whether the conclusions reached by stakeholders in applying IFRS 17 are appropriate.

Respondents to the Exposure Draft

15. We received two examples of compulsory insurance arrangements in which the premiums charged to policyholders are determined by a regulator—one example from North America (paragraphs 16–17) and another from Asia-Oceania (paragraph 18).

16. In the first example, an entity is the only issuer of compulsory public auto insurance in a specific region. Adjustments to future premiums may take place if:

    (a) the entity's capital ratio exceeds a specified cap—in this case, the regulatory framework imposes an obligation on the entity to decrease future premiums.

In some circumstances, the regulator could also require the entity to decrease future premiums before the capital ratio exceeds that specified cap.

(b) the entity's capital ratio falls below a specified floor—in this case, the regulator has discretion on whether to permit the entity to increase future premiums. For example, the regulator may suspend an increase of future premiums for several years and instead implement other measures to address the decline in the entity's capital ratio such as measures leading to cost reduction.

17. We understand that the entity concluded:

(a) it would have an enforceable present obligation to decrease future premiums if the entity's capital ratio exceeds the specified cap or if the regulator requires it to decrease future premiums.

(b) it would not have an enforceable present right to increase future premiums if the entity's capital ratio falls below the specified floor because of the high degree of regulatory discretion.

18. In the second example, all entities issuing a specific type of compulsory insurance are required by law to participate in a pooling arrangement. A regulator determines the premiums charged by these entities. The arrangement is based on an objective that an entity should generate no-gain or no-loss over time for issuing compulsory insurance contracts. To achieve that objective, the regulator adjusts future premiums for the pool's overall gain or loss resulting from the cumulative underwriting results and cumulative investment income relating to all insurance contracts issued by the participating entities. Stakeholders have expressed the view that there is no need for the proposed model to supplement the application of IFRS 17 to this particular arrangement.

Accounting firms

19. We contacted four accounting firms. Three of the accounting firms have not identified insurance contracts within the scope of IFRS 17 that are likely to be affected by the proposals in the Exposure Draft.

20. One of the accounting firms thought a few insurance arrangements in North America may give rise to regulatory assets and regulatory liabilities—for example, public auto insurance such as that described in paragraphs 16–17, workplace injury insurance and new home warranty to protect home buyers. These arrangements generally involve an entity established by the government to provide compulsory insurance. Even though this accounting firm has not identified similar examples in other jurisdictions, there is a possibility that other jurisdictions may have similar compulsory insurance arrangements or could have similar arrangements in the future.

21. We discussed an example of an entity providing workplace injury insurance in a specific region. The entity determines the premiums charged to its policyholders (that is, employers) in accordance with legislation. The legislation also ensures that the entity is sufficiently funded by specifying the maintenance of a funding ratio. When the funding ratio:

    (a) exceeds a specific threshold, the entity is overfunded. In this case, the entity will design a plan to refund the surplus back to the policyholders by charging lower premiums in the future, which will be subject to government approval.

    (b) falls below a specific threshold, the entity is underfunded. In this case, the entity will design a plan to recover the deficit by charging higher premiums to policyholders in the future, which will be subject to government approval.

22. The accounting firm thought that on approval of an entity's plan to recover deficits or refund surpluses by the government, regulatory assets or regulatory liabilities might arise from the recovery of those deficits or refund of those surpluses.

Staff analysis

23. We note that during the development of IFRS 17, the IASB considered the effects of law or regulation on insurance contracts. For example, when determining the contract boundary, an entity is required to consider its substantive rights and obligations—whether they arise from contract, law or regulation.[2] There is also an exemption from dividing contracts into different groups when law or regulation constrains an entity's practical ability to set a different price or level of benefits for policyholders with different characteristics.[3]

24. Since IFRS 17 already considers the effects of law or regulation when accounting for insurance contracts, we think that a regulatory asset or regulatory liability would exist only if:

    (a) a regulator determines the premiums in a way that gives rise to differences in timing that represent present enforceable rights (obligations) to add (deduct) amounts to (from) future regulated premiums; and

    (b) the cash flows arising from those differences in timing are outside the boundary of the insurance contract.

25. The analysis in this section is structured as follows:

    (a) comparison with IFRS 9 (paragraphs 26–28);

    (b) should a scope exclusion be provided? (paragraphs 29–31); and

    (c) conclusion (paragraphs 32–33).

Comparison with IFRS 9

26. As part of the redeliberations on the Exposure Draft, the IASB has discussed the interaction between the model and IFRS 9 *Financial Instruments*. In this case, the IASB tentatively decided not to exclude from the scope of the final Standard

[2] Paragraph 2 of IFRS 17, and paragraphs 33–34 of IFRS 17.

[3] Paragraph 20 of IFRS 17.

regulatory assets or regulatory liabilities related to financial instruments within the scope of IFRS 9. This decision was based on:

(a) the understanding that the regulation of interest rates is typically limited to setting a cap or floor on interest rates and this type of regulation is not expected to give rise to differences in timing; and

(b) the fact that stakeholders contacted had not identified financial instruments within the scope of IFRS 9 that are likely to be affected by the final Standard.[4]

27. The situation with respect to IFRS 17 is different from the situation with respect to IFRS 9. As discussed in paragraphs 13–22, stakeholders have identified a few examples of insurance arrangements in which regulatory assets or regulatory liabilities might arise.

28. Consequently, the paragraphs that follow discuss whether to exclude these potential regulatory assets or regulatory liabilities from the scope of the final Standard.

Should a scope exclusion be provided?

29. A scope exclusion would mean that items that meet the definition of regulatory assets and regulatory liabilities would not be recognised, resulting in financial statement information that is less complete. Having said that, we have no feedback from entities issuing insurance contracts that the application of IFRS 17 results in significant rights and obligations not being accounted for. Our outreach only identified a few examples in which stakeholders thought a regulatory asset or regulatory liability might arise—these examples are limited to entities providing compulsory insurance required by statute, legislation or regulations.

30. When applying IFRS 17, entities are required to assess whether the cash flows affected by law or regulation fall within the boundary of an insurance contract (paragraph 23). If entities conclude that these cash flows do not fall within the boundary of the insurance contract, the final Standard would require that entities

[4] Agenda Paper 9E discussed at the May 2022 IASB meeting.

assess whether these cash flows relate to differences in timing that give rise to enforceable rights or enforceable obligations that fulfil the regulatory asset or regulatory liability definitions. Consequently, a scope exclusion would reduce the cost and effort of entities having to perform this additional assessment under the final Standard.

31. Furthermore, a scope exclusion would also:

(a) provide clarity about the scope of the final Standard by narrowing its focus to supplementing information an entity provides by applying IFRS 15. This would help respond to respondents' concern that the proposed scope was broader than intended.

(b) reinforce a previous IASB tentative decision—that is, to clarify in the final Standard that, for a regulatory asset or a regulatory liability to arise, it is necessary that differences in timing originate from and reverse through, amounts included in the regulated rates that an entity accounts for as revenue in accordance with IFRS 15.[5]

(c) minimise the following unintended consequences:

(i) potentially disrupting the application of IFRS 17.

(ii) adding complexity to the final Standard by having to modify or adapt the requirements in the final Standard for regulatory assets and regulatory liabilities that might arise from insurance contracts within the scope of IFRS 17.

Conclusion

32. We acknowledge that a scope exclusion could result in items that meet the definition of regulatory assets and regulatory liabilities not being recognised. However, the evidence gathered indicates the population of these regulatory assets and regulatory liabilities is limited as described in paragraph 29. We think the benefits of providing a

[5] Agenda Paper 9D discussed at the May 2022 IASB meeting.

scope exclusion outweigh the costs of not recognising regulatory assets and regulatory liabilities that might arise from insurance contracts within the scope of IFRS 17 (paragraphs 30–31).

33. Consequently, we recommend that the final Accounting Standard exclude regulatory assets and regulatory liabilities that might arise when premiums charged in insurance contracts within the scope of IFRS 17 are regulated.

Question for the IASB
1. Does the IASB agree with the staff recommendation in paragraph 33?