STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	Multi-currency Groups of Insurance Contracts (IFRS 17 and IAS 21)	
Paper topic	Initial consideration	
CONTACT(S)	Dennis Deysel	ddeysel@ifrs.org
	Anne McGeachin	amcgeachin@ifrs.org

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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about the application of IFRS 17 *Insurance Contracts* and IAS 21 *The Effects of Changes in Foreign Exchange Rates* to a group of insurance contracts with foreign currency cash flows.

2. This paper:
   (a) provides the Committee with a summary of the matter;
   (b) presents our research and analysis; and
   (c) asks the Committee whether it agrees with our recommendation not to add a standard-setting project to the work plan.

Structure of the paper

3. This paper includes:
   (a) background information;
   (b) outreach;
   (c) analysis of the questions asked; and
   (d) analysis of whether to add a standard-setting project to the work plan.

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4. There are three appendices to the paper:

   (a) Appendix A—proposed wording of the tentative agenda decision;

   (b) Appendix B—illustrative example; and

   (c) Appendix C—submission.

Background information

5. Paragraph 24 of IFRS 17 requires an entity to apply the recognition and measurement requirements in IFRS 17 to groups of insurance contracts. The measurement of a group of insurance contracts comprises:

   (a) the fulfilment cash flows (the estimate of the present value of the future cash flows adjusted to reflect financial and non-financial risks); and

   (b) a contractual service margin (unearned profit relating to the future service to be provided under the group of contracts).

6. The estimate of the future cash flows includes all the future cash flows within the boundary of each contract in the group, including premiums, claims and other cash flows such as claims handling costs and policy administration costs.

7. An entity that issues insurance contracts often conducts activities in more than one currency. An entity may, for example:

   (a) issue insurance contracts in more than one jurisdiction, with contracts denominated in the currency of the jurisdiction in which they are issued. An entity may, for example, issue insurance contracts in Pound Sterling in the UK, Euro in Germany, and Hong Kong Dollar in Hong Kong.

   (b) issue an individual insurance contract with cash flows in more than one currency, for example, a contract with premiums in Euro and claims in Euro and US Dollar.

   (c) issue insurance contracts in only one currency, for example, Euro, but incur costs such as policy administration costs in a different currency, for example, Pound Sterling.

The questions asked

8. Appendix C to this paper reproduces the submission. The submission asks three questions:

   (a) how and when does an entity determine the currency in which an individual insurance contract with cash flows in multiple currencies (a '**multi-currency'** contract) is denominated?

   (b) is an entity required to consider currency risk when assessing 'similar risks' for the purpose of identifying portfolios of insurance contracts?

   (c) how does an entity determine the currency in which the contractual service margin of a group of insurance contracts is denominated?

9. The first and third questions in the submission relate to the measurement of a group of insurance contracts with foreign currency cash flows. The second question relates to the requirements for establishing a group of insurance contracts.

10. In analysing the questions asked, we first consider the second question in the submission—whether an entity considers currency risk for the purpose of identifying portfolios of insurance contracts (referred to as **Question 1**). We then consider how an entity applies IFRS 17 and IAS 21 in measuring a group of insurance contracts with foreign currency cash flows (referred to as **Question 2**). Our analysis of Question 2 addresses both the first and third questions in the submission.

Outreach

11. We sent information requests to members of the Transition Resource Group for IFRS 17 (TRG), from which we received 10 responses. The submission was also made available on our website. In addition to responses from members of the TRG, we received input from an industry body and two preparers. All the responses represent informal opinions and do not necessarily reflect the official views of those respondents or their organisations.

12. The information request asked about:

    (a) the prevalence of multi-currency groups of insurance contracts (paragraph 13); and

    (b) how entities are implementing the requirements in IFRS 17 and IAS 21 in:

        (i) establishing groups of insurance contracts (paragraphs 15–27); and

        (ii) measuring groups of insurance contracts with foreign currency cash flows (paragraphs 28–48).

13. With regards to the prevalence of multi-currency groups of insurance contracts, most respondents said it is common for groups of insurance contracts to have foreign currency cash flows. They also said the complexity involved in measuring groups of insurance contracts with foreign currency cash flows varies depending on the circumstances, for example:

    (a) complex—a reinsurance contract with multiple underlying insurance contracts denominated in many currencies;

    (b) not so complex—a group of insurance contracts with all cash flows between the insurer and policyholders in a single currency, but with some administrative costs in a different currency.

14. We have summarised outreach responses on how entities are implementing the requirements in IFRS 17 and IAS 21 as part of our analysis of the questions asked (see paragraphs 15–48).

Analysis of the questions asked

Question 1: Establishing a group of insurance contracts

Applicable requirements (paragraphs 14−24 of IFRS 17)

15. IFRS 17 requires an entity to establish groups of insurance contracts applying a three-step approach:

(a) **Step 1—identify portfolios of insurance contracts (paragraph 14 of IFRS 17):**

An entity shall identify portfolios of insurance contracts. A portfolio comprises contracts subject to similar risks and managed together. Contracts within a product line would be expected to have similar risks and hence would be expected to be in the same portfolio if they are managed together. Contracts in different product lines (for example single premium fixed annuities compared with regular term life assurance) would not be expected to have similar risks and hence would be expected to be in different portfolios.

(b) **Step 2—group by profitability (paragraph 16 of IFRS 17):**

An entity shall divide a portfolio of insurance contracts into a minimum of:

(a) a group of contracts that are onerous at initial recognition, if any;

(b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and

(c) a group of the remaining contracts, if any.

(c) **Step 3—group by annual cohort (paragraph 22 of IFRS 17):**

An entity shall not include contracts issued more than one year apart in the same group…

16. An entity is permitted to subdivide groups further than the minimum required applying the three-step approach (paragraph 21 of IFRS 17).

Question

17. The submission asks whether currency risk is a risk that an entity is required to consider when assessing whether contracts are ‘subject to similar risks’ for the purpose of identifying portfolios of insurance contracts (**Step 1** above). For example, would or could an entity consider a motor insurance contract with cash flows in Euro

to be ‘subject to similar risks’ to a motor insurance contract with cash flows in Pound Sterling?

Outreach responses

18. All respondents (except one with no multi-currency groups of contracts) said a portfolio of insurance contracts could potentially include contracts with cash flows in different currencies.

19. Respondents said, in applying paragraph 14 of IFRS 17 and assessing whether contracts are ‘subject to similar risks’, entities generally focus on risks transferred from the policyholder to the entity under the contracts. They said, in most cases, currency risk is not considered to be one of the key risks in their insurance contracts. Entities have therefore often concluded that, applying IFRS 17, a portfolio of insurance contracts could include contracts with cash flows in different currencies.

20. Nonetheless, most respondents said there may be circumstances in which currency risk is considered to be a key risk in an insurance contract, and thus currency risk could influence an entity’s assessment of whether contracts are subject to similar risks.

21. Some respondents noted that some entities choose to subdivide groups of contracts by currency—when possible—to reduce operational complexity.

Staff analysis

22. IFRS 17 defines and describes financial risk and non-financial risk, including insurance risk. Currency risk is a financial risk[1]. When—in applying the requirements in IFRS 17—an entity is required to consider or reflect only particular risks (for example, only non-financial risk) and not others, IFRS 17 explicitly refers to the risks to be considered or reflected. In our view, because the portfolio requirements in paragraph 14 of IFRS 17 refer to ‘similar risks’ without specifying the types of risk to consider, this requirement is not limited only to non-financial risk. An entity would

[1] Appendix A to IFRS 17 defines financial risk as ‘the risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, currency exchange rate, index of prices or rates, credit rating or credit index or other variable…’.

therefore consider all risks when identifying portfolios of contracts. Financial risk—including currency risk—cannot be ignored.

23. With that said, in our view paragraph 14 of IFRS 17 does not require an entity to include contracts with cash flows in different currencies in different portfolios in all circumstances. What an entity considers to be 'similar risks' will depend on the nature and extent of the risks in the entity's contracts. 'Similar risks' do not mean 'identical risks'.

24. Paragraph 14 of IFRS 17 refers to 'contracts' for the purpose of identifying portfolios of insurance contracts. Accordingly, an entity cannot sub-divide a single insurance contract into separate currency cash flow streams to be measured separately.

25. Paragraph 14 also refers to 'contracts subject to similar risks and managed together'. Contracts within a product line would be expected to have similar risks (and contracts in different product lines to have dissimilar risks) but IFRS 17 includes no further requirements on how to assess whether risks are similar.

26. In assessing whether contracts are subject to 'similar risks', in our view it is helpful to consider the IASB's rationale for requiring an entity to identify portfolios of insurance contracts:

    (a) in explaining the IASB's considerations on striking a balance to achieve groupings of contracts that is neither too aggregated nor too disaggregated, paragraph BC123(a) of the Basis for Conclusions on IFRS 17 explains that the IASB:

    > …did not want entities to depict one type of contract as cross-subsidised by a different type of contract, but also did not want to recognise losses for claims developing as expected within a group of similar contracts…

    (b) paragraph BC124 of the Basis for Conclusions on IFRS 17 goes on to explain that, in principle, the balance could be achieved by, among other requirements:

    > … (a) requiring contracts in a group to have future cash flows the entity expects will respond similarly in amount and timing to changes in key assumptions—meaning that losses on insurance contracts for one type of insurance risk would not be

> offset by gains on insurance contracts for a different type of risk, and would provide useful information about the performance of contracts insuring different types of risk…

Staff Conclusion

27. We conclude that:

(a) ‘similar risks’ in paragraph 14 of IFRS 17 are not limited only to non-financial risks. An entity considers all risks, including currency risk, when identifying portfolios of insurance contracts.

(b) an entity could identify portfolios of contracts that include contracts subject to different currency risk because ‘similar’ does not mean ‘identical’. What an entity considers to be ‘similar risks’ will depend on the nature and extent of the risks in the entity’s contracts.

(c) in assessing whether contracts are subject to similar risks, it may be helpful to consider the IASB’s objectives and expectations when it developed the requirements on groups of insurance contracts. As explained in the Basis for Conclusions on IFRS 17, the IASB had as one of its objectives requiring entities not to depict one type of contract as cross-subsidised by another type of contract. Accordingly, it set requirements for grouping contracts (including the requirements for identifying portfolios) that would be expected to result in an entity generally grouping contracts together only if the contracts have future cash flows that the entity expects will respond similarly in amount and timing to changes in key assumptions.

Question 1 for the Committee
1. Does the Committee agree with our analysis of the application of the requirements in paragraph 14 of IFRS 17, outlined in paragraphs 22-27 of this paper?

Question 2: Measuring a group of insurance contracts with foreign currency cash flows

Applicable requirements in IFRS 17

28. Paragraph 30 of IFRS 17 states:

> When applying IAS 21…to a group of insurance contracts that generate cash flows in a foreign currency, an entity shall treat the group of contracts, including the contractual service margin, as a monetary item.

29. Paragraph BC277 of the Basis for Conclusions of IFRS 17 explains the IASB's decision in developing the requirements in paragraph 30 of IFRS 17:

> When applying IAS 21…, the fulfilment cash flows are clearly monetary items. However, the contractual service margin component might be classified as non-monetary because it is similar to prepayments for goods and services. The Board decided that is would be simpler to treat all components of the measurement of an insurance contract denominated in a single currency as either monetary or non-monetary. Because the measurement in IFRS 17 is largely based on estimates of future cash flows, the Board concluded that it is more appropriate to view an insurance contract as a whole as a monetary item.

30. Paragraph 44 of IFRS 17 lists the adjustments an entity needs to make to the carrying amount of the contractual service margin when measuring the contractual service margin at the end of the reporting period. Among the adjustments listed is 'the effect of any currency exchange differences on the contractual service margin' (paragraph 44(d)).

Applicable requirements in IAS 21

31. An entity's functional currency is 'the currency of the primary economic environment in which the entity operates'. Foreign currency is 'a currency other than the functional currency of the entity'. Monetary items are 'units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency' (paragraph 8 of IAS 21).

32. Paragraph 20 of IAS 21 describes a foreign currency transaction as:

> …a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:
>
> (a) buys or sells goods or services whose price is denominated in a foreign currency;
>
> (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
>
> (c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

33. An entity records a foreign currency transaction on initial recognition in its functional currency by applying the spot exchange rate at the date of the transaction (paragraph 21 of IAS 21).

34. Paragraph 23 of IAS 21 requires an entity to translate foreign currency monetary items into its functional currency using the closing rate at the end of each reporting period. Paragraph 24 of IAS 21 explains:

> The carrying amount of an item is determined in conjunction with other relevant Standards. For example…whether the carrying amount [of an item of property, plant and equipment] is determined on the basis of historical cost or on the basis of fair value, if the amount is determined in a foreign currency it is then translated into the functional currency in accordance with this Standard.

35. Paragraph 28 of IAS 21 requires that an entity recognise in profit or loss any exchange differences, with one exception unrelated to the questions in the submission.

Outreach responses

36. Respondents explained the approaches entities have adopted in implementing and applying IFRS 17 and IAS 21 to multi-currency groups of insurance contracts. **Broadly speaking**, the approaches adopted can be described as:

(a) **Approach 1—the group of insurance contracts (including the contractual service margin) is considered to be denominated in a single currency.**

If a group of insurance contracts has cash flows in more than one currency, on initial recognition an entity determines a single currency in which the multi-currency group of contracts is denominated—the entity might determine that single currency to be the currency of the premiums (see Appendix C—View 1 of Question 1 in the submission) or the currency of the predominant cash flows (if different from the currency of the premiums) (see Appendix C—View 2 of Question 1 in the submission).

The entity applies all the requirements in IFRS 17 to determine the carrying amount of the group of contracts, including the contractual service margin, in the single currency identified. Notably, the entity applies the requirements in IFRS 17 dealing with the effect of changes in financial risk when translating the cash flows into the single group currency and, if applicable, identifies the group as onerous applying the measurement in that currency. If that single currency is a foreign currency, the entity then applies IAS 21 and translates the carrying amount of the group of contracts into its functional currency at the end of each reporting period.

To illustrate, assume an entity—with a Euro functional currency—has a group of contracts with cash flows in US Dollars and Pounds Sterling. The entity determines that the group of contracts is denominated in US Dollar. The following diagram illustrates Approach 1:

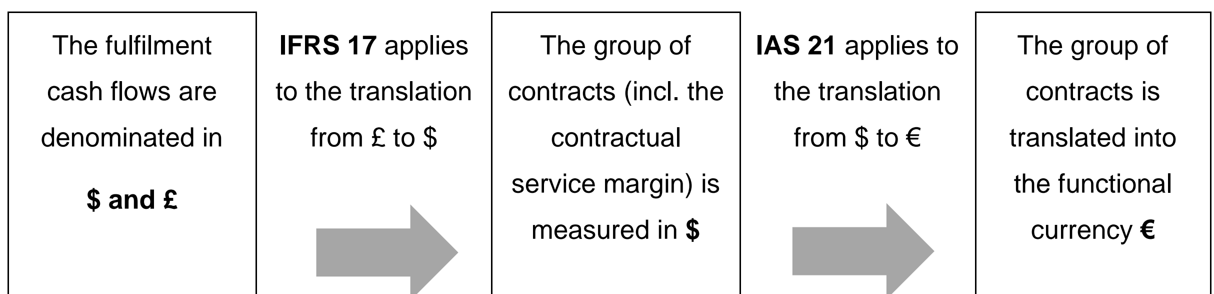

Diagram 1: Approach 1

(b) **Approach 2—the group of insurance contracts (including the contractual service margin) is considered to be denominated in multiple currencies, reflecting the currencies of the fulfilment cash flows.**

An entity translates the fulfilment cash flows in each foreign currency into its functional currency. It also identifies on initial recognition an amount of the contractual service margin relating to each currency and translates each foreign currency amount from the foreign currency into its functional currency. Subsequent changes in the cash flows in each foreign currency adjust the amount of the contractual service margin in the respective foreign currency before the adjusted amount is translated into the functional currency. Onerous losses are identified for the group in the functional currency.

To illustrate using the same example as used above to illustrate Approach 1, the following diagram illustrates Approach 2:

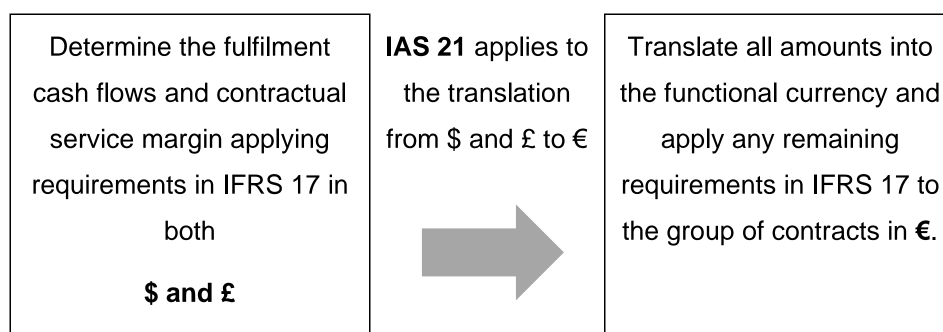

Diagram 2: Approach 2

37. Respondents explained why an entity may choose one or other of the above approaches depending on their circumstances. For example, an entity that has groups of insurance contracts with cash flows predominantly in one currency might apply Approach 1, whilst an entity that has groups of contracts with cash flows in multiple currencies of similar predominance might choose Approach 2.

Staff analysis

38. The requirements in both IFRS 17 and IAS 21 refer to situations or transactions in which there is a single foreign currency. Paragraphs 20 and 24 of IAS 21 and paragraph 30 of IFRS 17 refer to '**a** foreign currency' (emphasis added).

39. In analysing how to apply the requirements in IFRS 17 and IAS 21 to a multi-currency group of insurance contracts, we think it is helpful to:

    (a) first discuss the application of those requirements to a group of insurance contracts with cash flows in a single foreign currency (paragraphs 40–43); and then

    (b) discuss their application to a multi-currency group of insurance contracts (paragraphs 44–48).

Application of IFRS 17 and IAS 21 to a group of contracts with cash flows in a single foreign currency

40. Assume an entity—with a Euro functional currency—has a group of insurance contracts with cash flows all in Pound Sterling. The group of insurance contracts, including the contractual service margin, is denominated in the foreign currency, Pound Sterling, because that is the currency of the cash flows.

41. The entity applies IFRS 17 to measure the group of insurance contracts in Pound Sterling at the total of:

    (a) the fulfilment cash flows (the present value of the estimates of future cash flows adjusted for financial and non-financial risk) in Pound Sterling; and

    (b) the contractual service margin in Pound Sterling.

42. Paragraph 30 of IFRS 17 requires the entity to treat the group of contracts, including the contractual service margin, as a monetary item. Consequently, at the end of each reporting period, the entity translates the carrying amount of the group of insurance contracts (including the contractual service margin)—determined applying IFRS 17 in Pound Sterling—into its functional currency, Euro, using the closing rate (paragraph 23 of IAS 21). Applying paragraph 28 of IAS 21, the entity recognises exchange differences that arise in profit or loss.

43. We understand that some may hold the view that, because the nature of the contractual service margin (unearned profit) is more akin to a non-monetary item than a monetary item, the entity could translate the contractual service margin into Euro only on initial recognition, thereby treating the contractual service margin as denominated in the entity's functional currency of Euro. We disagree. Because the

group of contracts generates cash flows denominated in a single foreign currency, for the purposes of applying IAS 21 the group (including the contractual service margin) is denominated in that foreign currency. Accordingly, in our view at the end of each reporting period the entity must translate the carrying amount of the contractual service margin using closing rates.

Application of IFRS 17 and IAS 21 to a multi-currency group of contracts

44. Assume an entity—with a Euro functional currency—has a group of insurance contracts with cash flows in US Dollar and Pound Sterling.

45. Neither IAS 21, IFRS 17 nor any other IFRS Accounting Standard provides explicit requirements on how to determine the currency denomination of items that are denominated or require settlement in more than one currency. Nonetheless, there are requirements in IFRS 17 and IAS 21 with which an entity with a multi-currency group of insurance contracts must comply:

    (a) the entity applies IFRS 17 to measure the group of insurance contracts at the total of:

        (i) the fulfilment cash flows (measured using estimates that are current—reflecting conditions existing at the measurement date (paragraph 33(c) of IFRS 17) and—applying paragraph 23 of IAS 21—translates those cash flows into its functional currency, Euro, at closing rates; and

        (ii) the contractual service margin, which—applying paragraph 23 of IAS 21—the entity also translates into Euro at closing rates.

    (b) the entity recognises exchange differences that arise in profit or loss (paragraph 28 of IAS 21).

    (c) for the same reasons to those noted in paragraph 43 above, the entity cannot simply deem the contractual service margin for a multi-currency group of contracts to be denominated in the functional currency (as suggested in View 3 of Question 1 and View 2 of Question 3 in the submission (see Appendix C)).

46. In applying these requirements and depending on the terms of the contracts in the group, in our view the entity could apply either Approach 1 or Approach 2 described in paragraph 36 of the paper:

(a) applying Approach 1, the entity would determine a single currency that is one of the cash flow currencies (either US Dollar or Pound Sterling) in which the group of insurance contracts—including the contractual service margin—is denominated.[2] If we assume the group is denominated in US Dollar (as illustrated in Appendix B), the entity translates the Pound Sterling fulfilment cash flows into US Dollar when measuring the group of insurance contracts applying IFRS 17. Applying IFRS 17, the entity recognises the effect of subsequent changes in the Pound Sterling to US Dollar exchange rate as a change in financial risk in profit or loss (as insurance finance income or expenses) and does not adjust the contractual service margin. Applying IAS 21, the entity then calculates the exchange differences by translating the carrying amount of the group of insurance contracts (the fulfilment cash flows and the contractual service margin) in US Dollar into the entity's functional currency, Euro, using closing rates. The entity recognises those exchange differences in profit or loss (paragraph 28 of IAS 21).

(b) applying Approach 2, the entity would not determine a single currency in which the group of insurance contracts is denominated. Instead, it applies IAS 21 to calculate the exchange differences by measuring the sub-division of US Dollar-denominated fulfilment cash flows separately from the sub-division of the Pound Sterling-denominated fulfilment cash flows, and translating each into its functional currency, Euro, using closing rates. To apply IAS 21 to the contractual service margin, the entity determines the contractual service margin for each of the sub-divided fulfilment cash flows and translates the two amounts (one in US Dollar and one in Pound Sterling) into its functional currency, Euro, using closing rates. We note that an entity must measure one contractual service margin for a group of insurance contracts. Therefore, in applying Approach 2, the entity would ultimately recognise and measure one contractual service margin for the group of contracts—the two amounts of the contractual service margin is a technique to translate foreign currency.

[2] The entity might determine that currency to be the currency of the premiums or the predominant currency (as described in Views 1 and 2 of Question 1 in the submission).

47. **Appendix B** illustrates these two approaches using an example. The main measurement difference that arises from applying the approaches is how the entity calculates exchange differences on the contractual service margin and the resulting allocation to profit or loss. Using the example to illustrate, consider the effects on profit or loss:

Profit or loss for Year 1	**Approach 1**		**Approach 2**
	€		**€**
IFRS 17—Allocation of the contractual service margin	65.1 Cr		64.1 Cr
IFRS 17—Insurance finance income or expenses	5.7 Dr		-
Sub-total: Exchange differences on monetary items	*17.6 Dr*		*18.4 Dr*
IAS 21—Exchange differences on the fulfilment cash flows	9.6 Dr		15.3 Dr
IAS 21—Exchange differences on the contractual service margin	8.0 Dr		3.1 Dr
Net effect on profit or loss	41.8 Cr		45.7 Cr

Staff conclusion

48. We conclude that in measuring a multi-currency group of insurance contracts, an entity:

(a) applies all the measurement requirements in IFRS 17 to the group of contracts. In doing so, the entity recognises and measures one contractual service margin for the group of insurance contracts.

(b) in applying IAS 21, treats the group—including the contractual service margin—as a monetary item and at each reporting date translates the carrying amount at the closing rate (or rates).

(c) develops and applies an accounting policy to determine the currency (or currencies) in which the group—including the contractual service margin—is denominated. The entity develops an accounting policy based on its specific circumstances and the terms of the contracts in the group. The accounting policy must result in information that is relevant and reliable (as

described in paragraph 10 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) and be applied consistently for similar transactions, other events and conditions (paragraph 13 of IAS 8). In developing the accounting policy, because the group of insurance contracts generates cash flows in more than one currency, the entity cannot simply deem the contractual service margin for the group to be denominated in the entity's functional currency—doing so would, in effect, fail to treat the contractual service margin as a monetary item.

Question 2 for the Committee
2. Does the Committee agree with our analysis of the application of the requirements in IFRS 17 and IAS 21, outlined in paragraphs 38–48 of this paper?

Whether to add a standard-setting project to the work plan

Staff analysis and conclusion

49. Paragraph 5.16 of the IFRS Foundation *Due Process Handbook* states that the Committee decides to add a standard-setting project to the work plan only if all of the following criteria are met:

    (a) the matter has widespread effect and has, or is expected to have, a material effect on those affected;

    (b) it is necessary to add or change requirements in IFRS Accounting Standards to improve financial reporting—that is, the principles and requirements in IFRS Accounting Standards do not provide an adequate basis for an entity to determine the required accounting;

    (c) the matter can be resolved efficiently within the confines of the existing Standards and the *Conceptual Framework*; and

    (d) the matter is sufficiently narrow in scope that the IASB or the Committee can address it in an efficient manner, but not so narrow that it is not cost-

effective for the IASB or the Committee and stakeholders to undertake the due process required to change a Standard.

50. Outreach responses indicate that the matter has widespread effect and could have a material effect on entities affected (paragraph 5.16(a) of the *Due Process Handbook*). Our analysis in paragraphs 38–48 of this paper also indicates that, depending on the specific circumstances and the terms of the contracts, entities could use different approaches when applying IAS 21 to a multi-currency group of insurance contracts. Consequently, it may be necessary to add or change requirements in IFRS Accounting Standards to improve financial reporting (paragraph 5.16(b) of the *Due Process Handbook*). We have therefore considered whether the matter could be addressed efficiently if standard-setting were to be undertaken (paragraph 5.16(c) and (d) of the *Due Process Handbook*).

51. In our view, any standard-setting on the matter of how to account for the foreign currency aspects of multi-currency groups of contracts would require some considerable time and effort. It would involve, among other steps, developing requirements that could be applied to a broad range of multi-currency contracts—insurance contracts within the scope of IFRS 17 as well as contracts within the scope of other IFRS Accounting Standards. We have no evidence at this stage that the expected benefits of such standard-setting would outweigh the expected costs and that the matter is sufficiently narrow in scope for the IASB or the Committee to address it in an efficient manner.

Staff recommendation

52. For the reasons described in paragraph 51, we recommend that the Committee not add a standard-setting project to the work plan on the matter of how to account for the foreign currency aspects of multi-currency groups of contracts. Instead, we recommend that the Committee publish a tentative agenda decision that sets out the applicable requirements in IFRS 17 and IAS 21. In our view, the tentative agenda decision would be helpful in explaining how to ‘walk through’ the applicable requirements.

53. Appendix A to this paper sets out the proposed wording of the tentative agenda decision. In our view, the proposed tentative agenda decision (including the explanatory material contained within it) would not add or change requirements in IFRS Accounting Standards.[3]

Questions 3 and 4 for the Committee
3. Does the Committee agree with our recommendation not to add a standard-setting project to the work plan? 4. Does the Committee have any comments on the proposed wording of the tentative agenda decision in Appendix A to this paper?

[3] Paragraph 8.4 of the *Due Process Handbook* states: ‘Agenda decisions (including any explanatory material contained within them) cannot add or change requirements in IFRS Standards. Instead, explanatory material explains how the applicable principles and requirements in IFRS Standards apply to the transaction or fact pattern described in the agenda decision.’

Appendix A—proposed wording of the tentative agenda decision

Multi-currency Groups of Insurance Contracts (IFRS 17 *Insurance Contracts* and IAS 21 *The Effects of Changes in Foreign Exchange Rates*)

The Committee received a request about a group of insurance contracts that generate cash flows in more than one currency (a multi-currency group of insurance contracts).

The request asked:

a. whether an entity considers currency exchange rate risk when applying IFRS 17 to identify portfolios of insurance contracts; and

b. how an entity applies IAS 21 in conjunction with IFRS 17 in measuring a multi-currency group of insurance contracts.

Identifying portfolios of insurance contracts

IFRS 17 requires an entity to recognise and measure groups of insurance contracts. The first step in establishing groups of insurance contracts is to identify portfolios of insurance contracts. Paragraph 14 of IFRS 17 states that 'a portfolio comprises contracts subject to similar risks and managed together'. The request asks whether currency exchange rate risk is among the risks that an entity considers when assessing whether insurance contracts are 'subject to similar risks'.

Appendix A to IFRS 17 defines financial risk and insurance risk (a non-financial risk). Financial risk is defined to include 'the risk of a possible future change in…currency exchange rate'. When IFRS 17 requires an entity to consider or reflect only particular risks (for example, only non-financial risk), it explicitly refers to the risks to be considered or reflected. Consequently, the Committee concluded that, because paragraph 14 of IFRS 17 refers to 'similar risks' without specifying any particular types of risk, an entity is required to consider all risks—including currency exchange rate risk—when identifying portfolios of insurance contracts. However, 'similar risks' do not mean 'identical risks'. An entity could therefore identify portfolios of contracts that include contracts subject to different currency exchange rate risk. The Committee observed that what an entity considers to be 'similar risks' will depend on the nature and extent of the risks in the entity's insurance contracts.

Measuring a multi-currency group of insurance contracts

An entity measures a group of insurance contracts at the total of the fulfilment cash flows and the contractual service margin. Paragraph 30 of IFRS 17 states that 'when applying IAS 21…to a group of insurance contracts that generate cash flows in a foreign currency, an entity shall treat the group of contracts, including the contractual service margin, as a monetary item'.

Paragraph 8 of IAS 21 defines monetary items as 'units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency' and paragraph 20 describes a foreign currency transaction as 'a transaction that is denominated or requires settlement in a foreign currency'. Paragraphs 21–24 of IAS 21 requires an entity:

a. on initial recognition, to recognise a foreign currency transaction in the functional currency at the spot exchange date at the date of the transaction;

b. to determine the carrying amount of a monetary item in conjunction with other relevant Accounting Standards; and

c. to translate foreign currency monetary items into the functional currency using the closing rate at the end of each reporting period.

The requirements in both IFRS 17 and IAS 21 refer to transactions or items that are denominated or require settlement in a single foreign currency. IFRS Accounting Standards include no explicit requirements on how to determine the currency denomination of transactions or items that generate cash flows in more than one currency.

The Committee therefore observed that, in measuring a multi-currency group of insurance contracts, an entity:

a. applies all the measurement requirements in IFRS 17 to the group of contracts. In doing so, the entity recognises and measures one contractual service margin for the group of insurance contracts.

b. in applying IAS 21, treats the group—including the contractual service margin—as a monetary item and, at the end of each reporting period, translates the carrying amount at the closing rate (or rates).

c. develops an accounting policy to determine the currency (or currencies) in which the group—including the contractual service margin—is denominated. The entity uses its judgement in developing and applying an accounting policy based on its specific circumstances and the terms of the contracts in the group. The accounting policy must result in information that is relevant and reliable (as described in paragraph 10 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) and be applied consistently for similar transactions, other events and conditions (paragraph 13 of IAS 8). In developing the accounting policy, because the group of insurance contracts generates cash flows in more than one currency, the entity cannot simply deem the contractual service margin for the group to be denominated in its functional currency—doing so would, in effect, fail to treat the contractual service margin as a monetary item.

In the light of its analysis, the Committee considered whether to add to the work plan a standard-setting project on how to account for the foreign currency aspects of multi-currency groups of insurance contracts. The Committee observed that it has not obtained evidence that such a project would be sufficiently narrow in scope that the IASB or the Committee could address it in an efficient manner. Consequently, the Committee [decided] not to add a standard-setting project to the work plan.

Appendix B—Illustrative example

B1. This appendix illustrates the two approaches described in paragraph 36 of the paper:

(a) Approach 1—the group of insurance contracts (including the contractual service margin) is considered to be denominated in a single currency. If that single currency is a foreign currency, the entity applies IAS 21 to translate the group of contracts into its functional currency; and

(b) Approach 2—the group of insurance contracts (including the contractual service margin) is considered to be denominated in multiple currencies, reflecting the currencies of the fulfilment cash flows. The entity applies IAS 21 to translate the foreign currency components of the group of contracts into its functional currency.

Fact pattern

B2. An entity has a functional currency of Euro (€).

B3. At the beginning of Year 1, the entity issues a group of insurance contracts with premiums in US Dollar (US$) and claims in US$ and Pound Sterling (£). The coverage period is three years. Premiums are received at the start of each period and claims paid at the end of each period.

B4. The insurance contracts provide insurance coverage to policyholders evenly over the three-year coverage period. The entity provides no other insurance contract services under the contracts. The contracts also include no direct participation features, separable embedded derivatives or other non-insurance components.

B5. The group of insurance contracts generates the following expected future cash flows over the coverage period:

	Year 1	Year 2	Year 3	**Total**
Premiums (US$)	400	400	400	**1,200**
Claims (US$)	(100)	(100)	(100)	**(300)**
Claims (£)	(200)	(200)	(200)	**(600)**

B6. The **rounded** exchange rates applicable for the application of both IFRS 17 and IAS 21 are:

	At recognition	End of Year 1
US$1	£0.86	£0.85
US$1	€0.95	€1.00
£1	€1.11	€1.18

B7. For simplicity, everything occurs as the entity expects at initial recognition. The example also ignores the time value of money and the risk adjustment for non-financial risk.

Illustration of approaches

B8. At **initial recognition**, the carrying amounts of the fulfilment cash flows and the contractual service margin for the group of contracts are calculated as follows:

	Approach 1				**Approach 2**			
Items:	**The group is denominated in, and the IFRS 17 amounts are determined in:**		**Applying IAS 21, the $ amounts are then translated into:**		**IFRS 17 amounts are determined in both:**		**Applying IAS 21, the $ and £ amounts are then translated into:**	
	$		**€**		**$**	**£**	**€**	
Fulfilment cash flows								
Premiums ($)		1,200.0 Dr			1,200.0 Dr		(1,200 × 0.95)	1,142.8 Dr
Claims ($)		300.0 Cr			300.0 Cr		(300 × 0.95)	285.7Cr
Claims (£)	(600 × (1 ÷ 0.86))	700.0 Cr				600.0 Cr	(600 × 1.11)	666.7 Cr
		200.0 Dr	(200.0 × 0.95)	**190.4 Dr**	900.0 Dr	600.0 Cr		**190.4 Dr**
Contractual service margin		200.0 Cr		**190.4 Cr**	900.0 Cr	600.0 Dr		**190.4 Cr**

B9. Even though the mechanics of the two approaches differ, at initial recognition the carrying amounts of the fulfilment cash flows and the contractual service margin for the group of contracts are the same.

B10. At the **end of Year 1**, the change in the carrying amount of the **fulfilment cash flows** is calculated as follows:

	Approach 1		**Approach 2**		
	The group is denominated in, and the IFRS 17 amounts are determined in:	**Applying IAS 21, the $ amounts are then translated into:**	**IFRS 17 amounts are determined in both:**		**Applying IAS 21, the $ and £ amounts are then translated into:**
	$	**€**	**$**	**£**	**€**
Opening balance	-	-	-	-	-
Contracts issued (paragraph B8 of the paper)	200.0 Dr	190.4 Dr	900 Dr	600 Cr	190.4 Dr
Premiums received ($)	400.0 Cr	(400 × 0.95) 380.9 Cr	400 Cr		(400 × 0.95) 380.9 Cr
Claims paid ($)	100.0 Dr	(100 × 1) 100 Dr	100 Dr		(100 × 1) 100 Dr
Claims paid (£)	(200 × (1 ÷ 0.85)) 235.2 Dr	(235.2 × 1) 235.2 Dr		200 Dr	(200 × 1.17) 235.2 Dr
Closing balance (A)	**135.2 Dr**	**144.7 Dr**	**600 Dr**	**400 Cr**	**144.7 Dr**
Insurance finance income or expenses (C)	(B – A) 5.8 Cr	(5.8 × avg.) 5.7 Cr			-
Exchange differences (Dr) (profit or loss)		(B - (A - C)) 9.6 Cr			(B – A) 15.3 Cr
Closing balance (B)[(a)]	**129.4 Dr**	**129.4 Dr**	**600 Dr**	**400 Cr**	**129.4 Dr**

[(a)]The closing balance (B) is calculated as follows:

Closing balance (B)	**Approach 1**		**Approach 2**		
Fulfilment cash flows measured using current assumptions at end of Year 1	**The group is denominated in, and the IFRS 17 amounts are determined in:**	**Applying IAS 21, the $ amounts are then translated into:**	**IFRS 17 amounts are determined in both:**		**Applying IAS 21, the $ and £ amounts are then translated into:**
	$	**€**	**$**	**£**	
Premiums ($)	800.0 Dr		800 Dr		(800 × 1) 800.0 Dr
Claims ($)	200.0 Cr		200 Cr		(200 × 1) 200.0 Cr
Claims (£)	(400 × (1 ÷ 0.85) 470.5 Cr			400 Cr	(400 × 1.18) 470.6 Cr
	129.4 Dr	(129 × 1) **129.4 Dr**	**600 Dr**	**400 Cr**	**129.4 Dr**

B11. The two approaches result in the same carrying amount of the fulfilment cash flows (€129.4 Dr) and the same total effect in profit or loss (€15.3).

B12. At the end of **Year 1**, the change in the carrying amount of the **contractual service margin** is calculated as follows:

	Approach 1			**Approach 2**			
	The group is denominated in, and the IFRS 17 amounts are determined in:	**Applying IAS 21, the $ amounts are then translated into:**		**IFRS 17 amounts are determined in both:**		**Applying IAS 21, the $ and £ amounts are then translated into:**	
	$	**€**		**$**	**£**	**€**	
Opening balance	-	-		-	-	-	
Contracts issued (paragraph B8)	200.0 Cr		190.4 Cr	900 Cr	600 Dr		190.4 Cr
Amount allocated to profit or loss for services provided	(200 ÷ 3 years) 66.7 Dr	(66.7 × avg.)	65.1 Dr	300 Dr	200 Cr	(300 × avg.) – (200 × avg.)	64.1 Dr
Sub-total (A)	**133.3 Cr**		**125.3 Cr**	**600 Cr**	**400 Dr**		**126.3 Cr**
Exchange differences (Dr) recognised in profit or loss		(A – B)	8.0 Cr			(A – B)	3.1 Cr
Closing balance (B)		(133.3 × 1)	**133.3 Cr**	**600 Cr**	**400 Dr**	(600 × 1) – (400 × 1.18)	**129.4 Cr**

B13. As illustrated in paragraph 47, the exchange differences on the group of contracts amounts to a loss of €17.6 and €18.4 respectively applying Approach 1 and Approach 2. Applying Approach 1, the change in currency risk (reported in insurance finance income or expenses) amounts to an expense of €5.7. The main measurement difference arises from how the entity calculates:

(a) *the exchange differences on the contractual service margin*—applying Approach 1, the entity calculates the IAS 21 exchange differences as the difference resulting from translating the amounts in the group currency of $ into the functional currency of €. This amounts to exchange differences of €8.0. Applying Approach 2, the exchange differences are the differences resulting from translating the amounts denominated in the currencies of the cash flows ($ and £) into the functional currency of €. This amounts to exchange differences of €3.1.

(b) *change in currency risk*—applying Approach 1, the entity recognises the effect of subsequent changes in the £:$ exchange rate as a change in financial risk in profit or loss, within insurance finance income or expenses. Applying Approach 2, the effect of subsequent changes in the £:$ exchange rate forms part of the IAS 21 exchange differences under (a) above.

Appendix C—Submission

C1. We have reproduced the submission below.

Background

This submission considers the following scenarios observed in the insurance market where insurance contracts have cash flows in multiple currencies. These are not all-inclusive and other fact patterns may be observed in the market. Scenario 1 is described using actual jurisdictions and currencies. This is for illustrative purposes only and is not intended to imply that the issue is specific to a given jurisdiction.

Scenario 1: Insurer 1 operates in Taiwan and its functional currency is Taiwanese dollar (TWD). Insurer 1 issues an insurance contract in which premiums and claims are denominated in US dollars (USD) but the insurance contract-related expenses are denominated in TWD. The insurer and the policyholder are domiciled in Taiwan, with the insurance coverage being provided within Taiwan. Insurer 1 also issues identical insurance contracts in Taiwan except that premiums and claims are denominated in TWD.

Scenario 2: Insurer 2 issues two types of car insurance contracts for policyholders who plan to drive their cars overseas. These two types of contracts have identical terms and conditions except for the fact that one type includes contractual terms under which the payment of claims will be in the currency of the country in which the insured event occurs and the policy limits have been guaranteed in the relevant foreign currency denomination in a table attached to the contract that has been calculated annually by Insurer 2 for all of the major foreign currencies. The other type of insurance contract pays claims in the same currency as premiums in all cases irrespective of where the insured event occurs. For contracts in which the claims are payable in foreign currency, the policyholders receive the foreign currency-denominated claims payments based on the spot foreign exchange rate of the day the insurer has accepted to pay them. Premiums and expenses for both contracts are denominated in the currency of the country in which both the insurer and the policyholder are domiciled which happens to be the functional currency of Insurer 2.

For insurance contracts with cash flows in different currencies, such as those illustrated in Scenarios 1 and 2, an accounting issue arises with regards to the currency in which the

contractual service margin (CSM) of such group of contracts should be denominated in. IFRS 17:30 indicates that the CSM is a monetary item, and any effect of changes in exchange rates of the currency of the CSM are accounted for in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*. IAS 21:8 defines monetary items as "units of currency held or assets and liabilities to be received or paid in a fixed or determinable number of units of currency." However, CSM is neither an asset nor a liability to be received or paid in a fixed or determinable number of units. The Board recognised that fact in IFRS 17:BC277 (emphasis added):

When applying IAS 21, *The Effects of Changes in Foreign Exchange Rates*, the fulfilment cash flows are clearly monetary items. ***However, the contractual service margin component might be classified as non-monetary because it is similar to prepayments for goods and services.*** The Board decided that it would be simpler to treat all components of the measurement of an insurance contract denominated in a single currency as either monetary or non-monetary. Because the measurement in IFRS 17 is largely based on estimates of future cash flows, the Board concluded that it is more appropriate to view an insurance contract as a whole as a monetary item.

When all of the cash flows for the contracts within a group are denominated in a single currency, it seems clear that IFRS 17 requires the currency for the CSM to be the same as the currency of the underlying cash inflows and outflows. However, when the cash inflows and outflows of a group of insurance contracts are denominated in different currencies, IFRS 17 does not provide guidance on the currency in which the CSM should be considered denominated.

We believe that it would be useful to address three related issues:

1. The determination of the currency in which an individual insurance contract is considered denominated when the contract includes cash flows in multiple currencies, and at which date this determination is made;
2. Whether foreign currency risk is a risk to be taken into consideration when assessing "similar risks" for the purpose of determining portfolios of insurance contracts;
3. The determination of the currency in which the CSM of a group of insurance contracts is established within a given portfolio.

We explain these three issues in turn below.

Currency denomination of an insurance contract with cash flows denominated in multiple currencies

Question 1

In which currency is an individual insurance contract considered denominated when the contract includes cash flows in multiple currencies and at which date is that currency denomination determined?

> *View 1 – The insurance contract is denominated in the currency of the premiums, as determined at the initial recognition of the contract and not subsequently reassessed.*

An insurance contract is denominated in the currency of its premiums because these are the dominant cash flows in profitable contracts. This is the currency that has the greatest influence on the determination of the overall currency of the contract given cash inflows are expected to be greater than cash outflows at initial recognition for contracts that are not onerous. The currency denomination for the insurance contract is determined at the initial recognition of the insurance contract and is not reassessed subsequently.

Supporters of this view argue that this approach provides a direct link between the determination of the currency of the contract's cash flows (and their changes) and the determination of the group CSM balance. The interaction between IFRS 17:30 (which stipulates that a group of insurance contracts is a monetary item), IFRS 17:44(d) and 45(d) (which address how to account for the adjustment of the CSM for the effect of currency exchange differences) and IFRS 17:92 (which stipulates that foreign exchange gains and losses are recognised in profit or loss or in other comprehensive income) requires a close alignment of the CSM to the currency of the cash flows used to establish its initial measurement and the determination of the associated number of currency units denominated in the resulting currency.

Supporters of View 1 argue that considering the "predominant" cash flow denomination as expressed in View 2 could create groups of contracts that are denominated in different currencies within the same portfolio. For example, this would be the case when the predominant cash flows are the outflows in an onerous group of contracts while the predominant cash flows are the cash inflows in a profitable group of contracts in the same portfolio and possibly the same period. This is further complicated by the fact that when an

onerous contract becomes profitable in subsequent periods the CSM would be denominated in the currency of the outflows as it was set at initial recognition. This complication appears to be contrary to the approach that could be derived by IFRS 17:30. Accordingly, supporters of View 1 believe that assessing the currency denomination of an insurance contract based on the currency of its premiums/inflows is more in line with IFRS 17 than View 2.

> *View 2 – The insurance contract is denominated in the currency of the "predominant" cash flows, as determined at the initial recognition of the contract and not subsequently reassessed.*

Under this view, the insurance contract is denominated in the currency of the predominant cash flows. Similar to View 1, the currency denomination for the insurance contract is determined at initial recognition of the insurance contracts and is not reassessed subsequently. This means that the currency in which the insurance contract is denominated, once determined at initial recognition, does not change even when the predominant currency of the fulfilment cash flows changes over the lifetime of the contract (e.g. following collection or disbursement of cash flows in a particular currency that were previously expected and dominant).

Supporters of View 2 acknowledge that 'predominant' is not a defined term in IFRS Standards, thus the application of View 2 requires judgement, considering all the cash flows arising from the contract.

Supporters of this view argue that it aligns with the view set out in IFRS 17:BC277-BC278 whereby the Board viewed the whole of the insurance contract as a monetary item because the measurement in IFRS 17 is largely based on estimates of future cash flows, resulting in the whole contract also being accounted for as a single monetary item (i.e. inclusive of its contribution to the CSM of the group of contracts in which the particular contract belongs).

Supporters of View 2 argue that View 1 is an application of View 2 when the predominant cash flows are the premiums. However, View 1 does not address cases in which the premium cash flows are not the predominant cash flows, such as for onerous contracts. At initial recognition, IFRS 17:16 requires all onerous contracts to be in a group of contracts of their own.

View 3 – The insurance contract is not denominated in any particular currency with all foreign currency cash flows translated to the entity's functional currency.

Supporters of View 3 consider that where a single contractual arrangement has multiple currencies then for each foreign currency element it is accounted for under IAS 21. Under View 3, an insurer is required to isolate the foreign currency cash flows of insurance contracts with cash flows in multiple currencies and translate them into the functional as if they were separate streams of cash flows.

Applying View 3, the resulting net inflow or net outflow at initial recognition of a contract with multi-currency cash flows contributes to the CSM balance of the group of contracts it belongs to, as determined by translating the foreign currency net inflow or net outflow into the functional currency of the insurer and then applying IFRS 17:38 guidance on the CSM measurement for the group.

The CSM of the group of insurance contracts with multiple currencies cash flows will always be denominated in the functional currency of the entity. Supporters of View 3 argue that this is consistent with the nature of CSM as unearned profit. This accounting treatment is aligned with IAS 21:21 and offers an analogy to the treatment of a prepayment of future services under IFRS 15 *Revenue from Contracts with Customers*, as interpreted in IFRIC 22 *Foreign Currency Transactions and Advance Consideration*. Although the IFRIC 22 addresses the accounting treatment of non-monetary items, supporters of View 3 argue that the non-monetary nature of CSM is admitted in IFRS 17:BC277 as a characteristic of the CSM, which is a deferral of profit to be recognised as services are provided, thus making the analogy to IFRIC 22 on the accounting for a prepayment of future services relevant to interpret the interaction between IFRS 17 and IAS 21.

Consideration of foreign currency risk when identifying a portfolio of insurance contracts

Once the currency of an insurance contract has been determined, the next step is to determine the portfolio to which the contract belongs. For insurance contracts denominated in different currencies, the accounting issue of whether foreign currency risk is a risk that should be taken into account when identifying a portfolio of insurance contracts is important because, depending on the view taken, it could result in otherwise identical contracts being considered as having dissimilar risks due to exposure to foreign currency risk. Hence, depending on the view taken, a portfolio may be comprised of contracts with the same currency or contracts with cash flows in multiple currencies.

IFRS 17:14 requires insurers to identify a portfolio of insurance contracts. A portfolio of contracts is defined as comprising contracts that are subject to similar risks and are managed together. As an example, IFRS 17:14 provides that contracts within the same product line would be expected to have similar risks and hence would be expected to be in the same portfolio if they are being managed together. No further guidance is provided as to what constitute “similar risks.”

Whilst there is no further guidance on "similar risks" for the establishment of portfolios, Appendix A of IFRS 17 defines risks as follows (emphasis added):

Financial risk – The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, ***currency exchange rate****, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.*

Insurance risk – Risk, other than financial risk, transferred from the holder of a contract to the issuer.

Question 2 focuses only on foreign currency risk and its implication on the identification of a portfolio of contracts. Other aspects of the definition of portfolio, i.e. “similar risks” (excluding the impact of foreign currency risk) and “managed together”, are not considered in this question.

Question 2

Should foreign currency risk be taken into consideration when assessing "similar risks" for the purpose of determining portfolios of insurance contracts?

> *View 1 – No, foreign currency risk is not considered a risk that is relevant when assessing whether contracts have similar risks for the purposes of identifying portfolios. Contracts with cash flows in different currencies can be included within the same portfolio and, consequently, within a group of contracts (subject to the criteria in IFRS 17:22).*

Supporters of this view argue that foreign currency risk is not an insurance risk that is transferred from the policyholder to the insurer. They note that, like expense risk and lapse risk, foreign currency risk is a risk that is created by the contract itself and does not pre-exist the contract. The exposure to foreign currency risk results from an entity's business to issue insurance contracts with exposure to foreign currency fluctuations.

Applying View 1 to Scenario 1 above, the insurance contracts issued by Insurer 1 within the same product line can be included in the same portfolio, regardless of whether the premiums and claims are denominated in USD or TWD. A similar conclusion applies to Scenario 2, where insurance contracts issued that are within the same product line but include cash flows in multiple currencies can be included in the same portfolio.

The practical implication of View 1 is that it requires a greater amount of judgement in determining the currency of the CSM of the groups of insurance contracts belonging to portfolios of contracts with cash flows in different currencies. This is because, in applying this View 1, contracts that have similar risks (excluding foreign currency risk) and are managed together could result in a group of contracts where the individual contracts are denominated in multiple currencies (only applicable for Views 1 and 2 for Question 1) . Supporters of this view, however, acknowledge that the insurer, in applying View 1, can also choose to group contracts within the portfolio based on the currency denomination applying IFRS 17:21 guidance by analogy. This would make it operationally easier to determine the currency of the CSM currency of the group of contracts since all contracts within the group would have the same currency denomination.

View 2 – Yes, foreign currency risk is a relevant risk to consider when assessing whether contracts have similar risks. Depending on the facts and circumstances, the exposure to multiple currencies could require that insurance contracts within the same product line be aggregated in different portfolios.

Supporters of this view argue that although the foreign currency risk would not give rise to an insured event and is not in itself relevant when assessing the significance of insurance risk in a contract, it is a valid and relevant risk when assessing "similar risks" for identifying portfolios of contracts.

In Agenda Paper 2 of the February 2018 TRG meeting, the IASB staff noted that the policyholder risk referred to in IFRS 17:34 includes both the insurance risk and financial risk transferred from the policyholder to the insurer and excludes lapse risk and expense risk. The definition of financial risk, as set out in Appendix A of IFRS 17, includes the risk *"of a possible future change in […] currency exchange rate"*.

In applying this view, professional judgement needs to be applied. Supporters of this view argue that when the foreign currency risk is directly linked to the features of a contract and is assessed as a policyholder risk (i.e. a transferred risk), foreign currency risk can create a "dissimilar risk" from other otherwise similar contracts within the same product line that do not transfer of foreign currency risk to the insurer.

Applying View 2 to Scenario 1, the insurance contracts with premiums and claims denominated in USD are identified as a separate portfolio from the portfolio of insurance contracts that have all cash flows in TWD. This is because in the first portfolio, the exposure to foreign currency risk (i.e. the risk that the claim incurred is in USD) is transferred from the policyholder to the insurer. If the cash flows of other contracts are in currencies other than the functional currency of the entity, a different foreign currency risk is transferred from the policyholder to the insurer necessitating different portfolios for different contracts.

Applying View 2 to Scenario 2, the car insurance contracts with claims paid in foreign currency are identified as a separate portfolio from the portfolio of car insurance contracts that have claims payable in the same currency as that of the premiums and expenses. This is because in the first portfolio, the exposure to foreign currency risk (i.e. the risk that the insured event occurs abroad, and the claim incurred is settled in a foreign currency) is transferred from the policyholder to the insurer.

In relation to this last point and the application of IFRS 17:30, supporters of this view also note that that in IFRS 17:BC124(a) the Board noted that the level of aggregation is a concept bound by the notion of cash flows that "*respond similarly in amount and timing to changes in key assumptions—meaning that losses on insurance contracts for one type of insurance risk would not be offset by gains on insurance contracts for a different type of risk*". These supporters argue that the foreign currency risk can be a key assumption in the measurement of an insurance contract. A contract that has different exposure to foreign currency risk than another contract would not respond in a similar way to changes in that variable thus corroborating that foreign currency risk is one of the risks that has to be "similar".

Finally, supporters of this view also observe that the Board noted in IFRS 17:BC277 that the intention in drafting IFRS 17 was to treat "*all components of the measurement of an insurance contract* ***denominated in a single currency*** *as either monetary or non-monetary*". They argue that the reference to a contract denominated in a single currency is an additional corroborating element supporting that groups and portfolios should be aggregated in such a way that they contain only contracts denominated in a single currency, either because all cash flows of the contracts have the same currency or if the contracts have multiple currency cash flows, the contracts are deemed to be denominated in the single currency.

Currency denomination of the CSM of a group of contracts with cash flows denominated in different currencies

Once the currency denomination of the contract and the portfolio in which it would belong has been established, it is necessary to determine the currency of the CSM of the group of insurance contracts.

Question 3

In which currency should the CSM of a group of insurance contracts be denominated?

View 1 – CSM currency of the group should be the currency of the insurance contracts in the group

Supporters of this view argue that the CSM is the amount of deferred profit in a contract and it represents the premium paid in excess of the expected claims and benefits.

The supporters of View 1 that also support the portfolio definition set out in View 1 of Question 2 believe that there is a logical flow between the insurance contract and the contract CSM's currency denomination (regardless if it is determined based on a contract premiums or its predominant cash flows) and the currency denomination of the CSM balance for the group.

Supporters of View 1 that support the portfolio definition set out in View 2 of Question 2 conclude that the insurer would apply the concept of predominance of the contract currency denomination to determine the currency of the CSM balance for the group.

Supporters of this view believe that the interaction between IFRS 17:30 (which stipulates that a group of insurance contracts is a monetary item), IFRS 17:44(d) and 45(d) (which address how to account for the adjustment of the CSM for the effect of currency exchange differences) and IFRS 17:92 (which stipulates that foreign exchange gains and losses are recognised in profit or loss or in other comprehensive income) requires a close alignment of the CSM to the currency of the cash flows used to establish its initial measurement and the determination of the associated number of currency units denominated in the resulting currency.

View 2 – CSM currency should be the functional currency of the entity

Supporters of View 2 consider that the CSM contributed by individual contracts to the group is denominated in the functional currency of the entity. These supporters would logically support View 3 in Question 1. They argue that this approach aligns with the treatment of a prepayment of future services under IFRS 15 and IFRIC 22. Although the analogy is with the accounting treatment of a non-monetary item, the non-monetary nature of the CSM is recognised in IFRS 17:BC277 and the accounting of the CSM as having the currency of the functional currency of the entity is not incompatible with the treatment of the whole insurance contract as a monetary item.

It is also to be noted that IFRS 17:44(d) and 45(d) are intended to capture the effects of any currency differences on the CSM when translating foreign currency items into the functional currency of the entity and therefore, in applying this view, the amount would be nil given that the CSM, including any changes therein, is already denominated in the functional currency.

The interaction between the views expressed in this submission can be summarised in the following table:

<table>
<tr><td></td><td colspan="2">Insurance portfolio – consideration of the foreign currency risk</td></tr>
<tr><td>Insurance contract – currency denomination</td><td>View 1 – Foreign currency risk is not one of the “similar risks” such that groups can contain contracts with different currency exposures. A group may contain multi-currency cash flows.</td><td>View 2 – Foreign currency risk is one of the “similar risks” such that groups contain contracts with similar currency exposures.</td></tr>
<tr><td>View 1 – the currency of the premiums</td><td>Contracts are grouped without regard to foreign currency risk. A group may contain multi-currency cash flows.

View 1 for Question 3 is the logical view to support for this combination of views - the currency of the CSM of the group is the currency of the predominant premiums in the group at initial recognition.</td><td rowspan="2">Contracts are grouped if their net cash flows (individual contract’s contribution to the CSM balance) are determined to be denominated in the same currency (based on the premium or predominant cash flow).

View 1 for Question 3 is the logical view to support for this combination of views, the currency of the CSM of the group is the same as the currency of the CSM of the individual contracts in the group at initial recognition.</td></tr>
<tr><td>View 2 – the predominant currency</td><td>Contracts are grouped without regard to foreign currency risk. A group may contain multi-currency cash flows.

View 1 for Question 3 is the logical view to support for this combination of views - the currency of the CSM of the group is the currency of the predominant premiums in the group at initial recognition.</td></tr>
</table>

View 3 – no denomination, each cash flow is denominated in its own currency	Contracts are grouped without regard to foreign currency risk. A group will contain multi-currency cash flows. View 1 for Question 3 is the logical view to support for this combination of views, the currency of the CSM of the group is the currency of the predominant premiums in the group at initial recognition.	Contracts are grouped if they have a similar mix of foreign currency cash flows, thus belonging to the same portfolio because they have "similar risks", including foreign currency risk. View 2 for Question 3 is the logical view to support for this combination of views, the currency of the group CSM is the functional currency of the entity.

Reasons for the Committee to address the issue

We believe that this accounting issue is prevalent in the global insurance market where major insurers have presence in multiple jurisdictions worldwide. We have observed differing views being applied as part of the ongoing implementation of IFRS 17. This issue is not related to a Board project that is expected to be completed in the near future.

For these reasons, we believe that this issue is urgent and meets the criteria for acceptance into the Committee's agenda.