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 how an entity accounts for insurance contracts with cash flows in more than one currency.

The request asked:

a. whether an entity considers currency exchange rate risks 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 group of insurance contracts with cash flows in more than one currency (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 risks are among the risks an entity considers when assessing whether insurance contracts are 'subject to similar risks'.

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 … [a] currency exchange rate'. When IFRS 17 requires an entity to consider or reflect only particular types of risk (for example, only non-financial risk), it explicitly refers to the risks to be considered or reflected.

Therefore, 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 risks—when identifying portfolios of insurance contracts. However, 'similar risks' does not mean 'identical risks'. Therefore, an entity could identify portfolios of contracts that include contracts subject to different currency exchange rate risks. 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 require an entity:

a. to recognise on initial recognition a foreign currency transaction in the functional currency at the spot exchange rate at the date of the transaction;
b. to determine the carrying amount of a monetary item in conjunction with other relevant IFRS Accounting Standards; and
c. to translate at the end of the reporting period foreign currency monetary items into the functional currency using the closing rate.

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

Therefore, the Committee 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 insurance contracts, including the requirement in paragraph 30 to treat the group—including the contractual service margin—as a monetary item.
b. applies IAS 21 to translate at the end of the reporting period the carrying amount of the group—including the contractual service margin—into the entity's functional currency at the closing rate (or rates).
c. uses its judgement to develop and apply an accounting policy that determines on initial recognition the currency or currencies in which the group—including the contractual service margin—is denominated (currency denomination). The entity could determine that the group—including the contractual service margin—is denominated in a single currency or in the multiple currencies of the cash flows in the group.

The entity develops an accounting policy on currency denomination that results in information that is relevant and reliable (as described in paragraph 10 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) and is applied consistently for similar transactions, other events and conditions (paragraph 13 of IAS 8). The accounting policy is developed based on the entity's specific circumstances and the terms of the contracts in the group. The entity cannot simply presume that the contractual service margin for the group is denominated in the functional currency. Such a presumption would, in effect, fail to treat the contractual service margin as a monetary item as required by paragraph 30 of IFRS 17.

Single-currency denomination versus multi-currency denomination

The entity's accounting policy on currency denomination determines which effects of changes in exchange rates are changes in financial risk accounted for applying IFRS 17 and which of these effects are exchange differences accounted for applying IAS 21.

A single-currency denomination treats:

a. changes in exchange rates between the currency of the cash flows and the currency of the group of contracts as changes in financial risk that an entity accounts for applying IFRS 17; and
b. changes in exchange rates between the currency of the group of contracts and the functional currency as exchange differences that an entity accounts for applying IAS 21.

A multi-currency denomination treats all changes in exchange rates as exchange differences that an entity accounts for applying IAS 21.

In applying IFRS 17, there is a single contractual service margin for the group of insurance contracts. Appendix A to IFRS 17 defines the contractual service margin as representing 'the unearned profit the entity will recognise as it provides insurance contract services under the insurance contracts in the group.' Accordingly, under a multi-currency denomination, the entity would:

a. assess whether the group of contracts is onerous considering the contractual service margin as a single amount.
b. prevent the carrying amount of the contractual service margin being negative by, when necessary to do so, recognising a loss.
c. determine the amount of the contractual service margin to recognise in profit or loss by applying a single method of determining the coverage units provided in the current period and expected to be provided in the future to the amounts denominated in the multiple currencies. This would result in the entity allocating each of the currency amounts of the contractual service margin translated into the functional currency equally to each coverage unit.

Conclusion

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 insurance contracts. The Committee observed that it has not obtained evidence that such a project would be sufficiently narrow in scope that the International Accounting Standards Board (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.