IFRS

STAFF PAPER

April 2019

IASB® meeting

Project	**Amendments to IFRS 17 *Insurance Contracts***
Paper topic	Supplement to Agenda Paper 2D *Annual improvements*—feedback from TRG meeting held on 4 April 2019

CONTACT(S)	Anne McGeachin	amcgeachin@ifrs.org	+44 (0) 20 7246 6486
	Andrea Pryde	apryde@ifrs.org	+44 (0) 20 7246 6491

Introduction

1. The Transition Resource Group for IFRS 17 *Insurance Contracts* (TRG) met on 4 April 2019. Some of the topics discussed at that meeting related to some of the minor changes to IFRS 17 discussed in Agenda Paper 2D *Annual Improvements*. This paper sets out feedback from the TRG on the changes discussed.

Amendment to clarify the definition of an investment component (paragraph 11 of Agenda Paper 2D)

2. As discussed in Agenda Paper 2D, IFRS 17 defines an investment component as the amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur. Paragraph BC34 of the Basis for Conclusions on IFRS 17 explains that an investment component is an amount that is paid to the policyholder *in all circumstances*. That explanation is not explicitly included the wording of the definition. For example, a contract may require the entity to pay an amount to the policyholder if the policyholder surrenders a contract during the coverage period. However, no amount is payable to the policyholder if the contract continues to the end of the coverage period without a claim being made. In this case a payment is made even if an insured event does not occur (on surrender during the coverage period) but a payment is

not made in all circumstances (if the contract continues to the end of the coverage period without a claim being made). It was not the Board's intention that such a contract should be regarded as including an investment component, instead the payment on surrender is a refund of premiums. The recommended amendment in Agenda Paper 2D clarifies the definition to achieve the Board's intention.

3. Some TRG members welcomed the clarification and thought it would be useful for many entities implementing IFRS 17. However, some observed that the clarification was unnecessary and could disrupt implementation. Some were concerned that it would change the population of contracts with an investment component. In addition, some noted they have been preparing to analyse payments to policyholders between amounts relating to insurance claims (included in insurance revenue and insurance service expenses) and repayments of investment components (excluded from insurance revenue and insurance service expenses). They observed that the clarification implies they would now need to analyse the amount not relating to insurance claims between investment components and a new component, refund of premiums. In particular, this analysis would be needed because of the requirement in paragraph 103(c) of IFRS 17 to disclose investment components separately. They had not been expecting to do such an analysis.

4. The feedback from the TRG reinforces the staff view that it is important to clarify when an investment component exists, so there is more consistent understanding of the term. In particular, this would mean that when a claim is paid, entities do not incorrectly include or exclude amounts from insurance revenue and insurance service expenses because they incorrectly identify investment components. For example:

   (a) in the example in paragraph 2 of this paper, if an entity incorrectly regarded the surrender amount as an investment component, that amount would be incorrectly excluded from insurance revenue and insurance service expenses when a claim was incurred.

   (b) in a contract that provides death cover for the whole life of the policyholder and cannot be cancelled, an amount will be paid to the policyholder in all circumstances, because the policyholder will certainly die. The insurance risk arises from the uncertain timing of death. If the entity did not correctly identify that an investment component exists and should be excluded from insurance revenue and insurance service expenses, the revenue and expenses would be overstated.

5. The feedback from the TRG indicates that there is confusion, and hence the possibility of diversity in practice, over the existence of investment components.[1]

6. The TRG discussion indicated that the analysis in the TRG paper may have given rise to concerns that were not intended. In response to the concerns raised by TRG members about the additional work they perceive as implied by the recommended clarification, the staff note that identifying the *amount* of an investment component is only necessary at the time a payment is made to a policyholder, to exclude it from insurance revenue and insurance service expenses. Any refund of a premium at that time is also excluded from insurance revenue and insurance service expenses. Hence, for the purpose of measuring revenue and expenses, a separate analysis of the amounts of an investment component and refund of premium is not needed.

7. In relation to the disclosure concern raised, the staff had not intended to require additional analysis of payments to policyholders at the time the payments are made, beyond the analysis of what amounts should be excluded from revenue and expenses. The staff will consider whether a consequential amendment should be proposed to the requirement for separate disclosure of the investment component.

Amendment to address disaggregation of changes in the risk adjustment for non-financial risk (paragraph 9 of Agenda Paper 2D)

8. As discussed in Agenda Paper 2D, IFRS 17 allows, but does not require, an entity to disaggregate changes in the risk adjustment for non-financial risk into those caused by the time value of money and financial risk and those caused by changes in non-financial risk. Paragraph B96(d) of IFRS 17 does not address the treatment

[1] The staff also observe that identifying an investment component will have increased significance for some entities given the Board's tentative decision in January 2019 to propose that an investment-return service can exist only if an investment component exists.

of changes caused by the time value of money and financial risk if they are disaggregated. The recommended amendment in Agenda Paper 2D corrects that inadvertent omission.

9. One TRG member observed that he thinks the option over the disaggregation of changes in the risk adjustment for non-financial risk relates only to presentation. He thinks that IFRS 17 prohibits disaggregation for measurement purposes. Hence, he thinks paragraph B96(d) of IFRS 17 should not be amended to treat changes caused by the time value of money and financial risk differently from other changes, even if they are disaggregated for presentation purposes. He thinks a presentation choice should not change the measurement of insurance contracts.

10. The staff observe that IFRS 17 does not specifically prohibit disaggregation for measurement purposes. Rather it is silent on how to treat disaggregated amounts of changes in the risk adjustment for non-financial risk. The model in IFRS 17 has clear requirements for the treatment of changes in the time value of money and financial risk. The staff recommendation in Agenda Paper 2D simply explicitly extends those requirements to such changes that have been disaggregated from the risk adjustment for non-financial risk. The staff regard this as filling a gap in the Standard rather than changing the Standard.

Amendment to clarify that changes in the measurement of a group of insurance contracts caused by changes in underlying items should be treated as changes related to the time value of money or assumptions that relate to financial risk (paragraph 14 of Agenda Paper 2D)

11. As discussed in Agenda Paper 2D, changes in value of the underlying items affect the measurement of:

    (a) insurance contracts with direct participation features—the fulfilment cash flows include changes in the policyholders' share of the fair value of the underlying items and the contractual service margin includes changes in the entity's share of the fair value of the underlying items; and

(b) insurance contracts without direct participation features—the fulfilment cash flows include payments that vary depending on returns on underlying items.[2]

12. Often the effect of a change in underlying items will fall within the definition of insurance finance income or expenses set out in paragraph 87 of IFRS 17, being caused by the time value of money or the effect of financial risks. However, some changes in underlying items do not fall into that definition, for example if the underlying items include non-financial assets. The staff nonetheless think that the Board intended that changes in the measurement of insurance contracts arising from changes in underlying items should be treated as insurance finance income or expenses, because the underlying items are regarded as investments that determine the amount of some payments to policyholders. This intention applies to both:

(a) the treatment of such changes not adjusting the contractual service margin for insurance contracts without direct participation features in the general model; and

(b) the presentation of such changes as insurance finance income and expenses not as insurance service expenses.

13. The recommended amendment in Agenda Paper 2D clarifies the definition of insurance finance income or expenses to achieve the Board's intention.

14. TRG members generally agreed that such changes in the *measurement* of the insurance contracts without direct participation features should not adjust the contractual service margin—ie such changes should be treated in the same way as insurance finance income or expenses. However, they did not agree with the *presentation* of such changes as insurance finance income or expenses. They thought the changes related to the effect of changes in non-financial assumptions on the underlying items should be presented as part of insurance service expenses.

[2] Paragraphs B98–B100 of IFRS 17 set out how to distinguish between changes in fulfilment cash flows caused by changes in underlying items and changes in discretionary cash flows.

15. For example, consider an entity that bears a CU100 experience loss on insurance contracts which are in turn the underlying items for other contracts that have a 50% participating share and are not. That loss is recognised in profit or loss as insurance service expenses. The amendment recommended in Agenda Paper 2D would clarify that the gain of CU50 from the participating contracts is insurance finance income, because it results from the policyholders' participation in the underlying items. Some TRG members think that because it arises from a sharing of the loss experience, the gain of CU50 should be shown in insurance service expenses, reducing the insurance service expenses from CU100 to CU50.

16. One TRG member also questioned whether there could be unintended consequences of treating the changes in the participating contracts as insurance finance income or expenses, for example the changes would be eligible for the risk mitigation option in the variable fee approach.

17. The staff continue to think that the effect of changes in underlying items on the measurement of insurance contracts should be regarded as financial effects arising from the policyholders' participation. The staff think that CU100 insurance service expense provides useful information about the underwriting performance on the underlying contracts and the CU50 insurance finance income gives useful information about the participatory aspect of the participatory contracts. That perspective would appropriately apply to all aspects of the IFRS 17 requirements for financial effects, including eligibility for the risk mitigation option in the variable fee approach.