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STAFF PAPER

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Project	Amendments to IFRS 17 *Insurance Contracts*
Paper topic	Credit cards that provide insurance coverage

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Purpose

1. This paper discusses credit card contracts that meet the definition of an insurance contract in IFRS 17 *Insurance Contracts* (referred to as 'credit card contracts that provide insurance coverage' in this paper).

Summary of staff recommendations

2. The staff recommend the International Accounting Standards Board (Board) amend IFRS 17 to exclude from the scope of the Standard credit card contracts that provide insurance coverage for which the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.

Structure of the paper

3. This paper provides:
   (a) an overview of the requirements in IFRS 17 and a summary of the Board's rationale for setting those requirements, including an overview of the Board's previous discussions (paragraphs 4−12 of this paper);
   (b) an overview of the concerns and implementation challenges expressed since IFRS 17 was issued (paragraphs 13−16 of this paper); and

(c) the staff analysis, recommendations and questions for Board members (paragraphs 17−42 of this paper).

IFRS 17 requirements and the Board's rationale

Scope of IFRS 17

4. IFRS 17 applies to all insurance contracts as defined in IFRS 17, regardless of the type of entity issuing the contracts, with some specific exceptions. The definition of an insurance contract in IFRS 17 is the same as the definition of an insurance contract in IFRS 4 *Insurance Contracts*, with minor clarifications to the related guidance in Appendix B of IFRS 4.[1]

5. The Board decided that IFRS 17 should apply to all entities issuing insurance contracts—as opposed to insurers only—because:

   (a) if an insurer that issues an insurance contract accounted for that contract in one way and a non-insurer that issues the same insurance contract accounted for that contract in a different way, comparability across entities would be reduced;

   (b) entities that might meet the definition of an insurer frequently have major activities in other areas as well as in insurance and would need to determine how and to what extent these non-insurance activities would be accounted for in a manner similar to insurance activities or in a manner similar to how other entities account for their non-insurance activities; and

   (c) a robust definition of an insurer that could be applied consistently from jurisdiction to jurisdiction would be difficult to create.

6. IFRS 17 carries forward from IFRS 4 some scope exclusions. Paragraph 7 of IFRS 17 excludes from the scope of the Standard various items that may meet the definition of insurance contracts, such as:

[1] The clarifications in IFRS 17 require that: (i) an entity should consider the time value of money in assessing whether the additional benefits payable in any scenario are significant; and (ii) a contract does not transfer significant insurance risk if there is no scenario with commercial substance in which the entity can suffer a loss on a present value basis.

(a) warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer. IFRS 15 *Revenue from Contracts with Customers* applies to those warranties. The Board noted that, if IFRS 17 were to apply to such warranties, entities would generally apply the premium allocation approach to such contracts, which would result in accounting similar to that which would result from applying IFRS 15. Further, in the Board's view, accounting for such contracts in the same way as other contracts with customers would provide comparable information for the users of financial statements for the entities that issue such contracts. Hence, the Board concluded that changing the existing accounting for these contracts would impose costs and disruption for no significant benefit.

(b) some financial guarantee contracts. An entity shall not apply IFRS 17 to financial guarantee contracts it issues unless it has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts. The Board decided to carry forward from IFRS 4, without any substantive changes, the option that permits an issuer of a financial guarantee contract to apply IFRS 9 *Financial Instruments* or IFRS 17 to such contracts because the option has worked in practice and results in consistent accounting for economically similar contracts issued by the same entity.

(c) the following contracts because they are in scope of other IFRS Standards:

(i) employers' assets and liabilities that arise from employee benefit plans (see IAS 19 *Employee Benefits* and IFRS 2 *Share-based Payment*);

(ii) retirement benefit obligations reported by defined benefit retirement plans (see IAS 26 *Accounting and Reporting by Retirement Benefit Plans*);

(iii) contractual rights or contractual obligations contingent on the future use of, or the right to use, a non-financial item (see IFRS 15, IAS 38 *Intangible Assets* and IFRS 16 *Leases*);

(iv) residual value guarantees provided by the manufacturer, dealer or retailer and lessees' residual value guarantees embedded in a lease (see IFRS 15 and IFRS 16); and

(v) contingent consideration payable or receivable in a business combination (see IFRS 3 *Business Combinations*).

7. Paragraph 8 of IFRS 17 also allows an entity a choice of accounting for a fixed-fee service contract that meets the definition of an insurance contract applying IFRS 15 instead of IFRS 17 if, and only if, the following three conditions are met:

(a) the entity does not reflect an assessment of the risk associated with an individual customer in setting the price of the contract with that customer;

(b) the contract compensates the customer by providing services, rather than by making cash payments to the customer; and

(c) the insurance risk transferred by the contract arises primarily from the customer's use of services rather than from uncertainty over the cost of those services.

8. Some stakeholders noted some entities issue both fixed-fee service contracts and other insurance contracts. For example, some entities issue both roadside assistance contracts and insurance contracts for damage arising from accidents. The Board decided to allow entities a choice of whether to apply IFRS 17 or IFRS 15 to fixed-fee service contracts to enable such entities to account for both types of contract in the same way.

Separating components from an insurance contract

9. For insurance contracts that include non-insurance components IFRS 17 requires an entity to:

(a) apply IFRS 9 to determine whether there is an embedded derivative to be separated from a host insurance contract and, if there is, to determine how to account for that derivative;

(b) account for any distinct investment component separately from a host insurance contract applying IFRS 9;

(c) account for any promise to transfer distinct goods or non-insurance services separately from a host insurance contract applying IFRS 15; and

(d) apply IFRS 17 to all remaining components of the host insurance contract—these components include embedded derivatives that are not separated, non-distinct investment components and promises to transfer non-distinct goods or non-insurance services.

10. IFRS 17 prohibits the separation of non-insurance components from an insurance contract if the specified criteria set out in paragraph 9 of this paper are not met. IFRS 17 is more restrictive in this regard than IFRS 4.

11. The Board decided to prohibit an entity from separating a non-insurance component when not required to do so by IFRS 17 because:

(a) it would be difficult for an entity to routinely separate components of an insurance contract in a non-arbitrary way and setting requirements to do so would result in complexity; and

(b) such separation would ignore interrelations between components, with the result that the sum of the values of the components may not always equal the value of the contract as a whole, even on initial recognition.

12. Therefore, the Board concluded that permitting separation of non-distinct non-insurance components would result in less useful information and reduce the comparability of the financial statements across entities.

Concerns and implementation challenges expressed since IFRS 17 was issued

13. Some stakeholders are concerned that IFRS 17 requires an entity to account for some credit card contracts as insurance contracts. Those stakeholders provided the following specific example of a credit card contract that meets the definition of an

insurance contract in IFRS 4 and in IFRS 17 if the transfer of insurance risk is significant:[2]

(a) the contract is a retail credit card facility subject to typical terms such as a credit limit, minimum monthly repayments, interest charged at a stated rate unless the balance is paid off in full by a specified date.

(b) the regulation of the jurisdiction where the entity issuing the credit card operates requires the entity to provide coverage for some purchases made by the customer using the credit card.[3] Under this coverage, the entity:

 (i) must refund the customer for some claims against a supplier in respect of a misrepresentation or breach of the purchase agreement (for example, if the goods are defective or if the supplier fails to deliver the goods) if the supplier does not rectify; and

 (ii) is entitled to be indemnified by the supplier for any loss suffered in satisfying its liability with its customer.

(c) according to this regulation, provided that the customer can demonstrate the link between the entity, the supplier and the customer itself:

 (i) the entity and the supplier are jointly and severally liable to the customer—ie the customer can choose whether to claim from the entity or from the supplier; and

 (ii) subject to a maximum amount, the customer can claim from the entity or from the supplier an amount in excess of the amount paid using the specific credit card (for example, the entire purchase price, even if only part of the purchase price was paid using the credit card, and any additional costs reasonably incurred as a result of the supplier failure).

[2] IFRS 4 and IFRS 17 provide examples of contracts that are insurance contracts if the transfer of insurance risk is significant. Those examples include contracts that compensate the holder if another party fails to perform a contractual obligation; for example, an obligation to construct a building (see paragraph B18(f) of IFRS 4 and paragraph B26(f) of IFRS 17).

[3] Purchases of goods and services with a purchase price that is within a specified range of money.

(d) the entity either does not charge any fee to the customer or charges an annual fee to the customer that does not reflect an assessment of the insurance risk associated with that individual customer.

14. Similar to the concerns and implementation challenges expressed by stakeholders for loans that transfer significant insurance risk,[4] those stakeholders observed that the requirements in IFRS 17 for the separation of non-insurance components (such as a loan or a loan commitment in a credit card) differ from the requirements in IFRS 4, which permit entities to separate a loan component from an insurance contract and apply IFRS 9 to the loan component.

15. Those stakeholders are therefore concerned that entities that currently account for a loan or a loan commitment in a credit card applying IFRS 9 would need to change the accounting for those contracts when IFRS 17 is effective, shortly after having incurred costs to develop a new credit impairment model to comply with IFRS 9.

16. The staff note that, in many cases, entities can choose to issue an insurance contract and a credit card contract as two separate contracts and therefore the concerns and implementation challenges discussed in paragraphs 13–15 of this paper are not relevant for all entities issuing credit card contracts.

Staff analysis and recommendation

17. Paragraph B26 of IFRS 17 provides examples of contracts that are insurance contracts if the transfer of insurance risk is significant. Those examples include contracts that compensate the holder if another party fails to perform a contractual obligation. The staff therefore think that the credit card contract discussed in paragraph 13 of this paper meets the definition of an insurance contract in IFRS 17 if the transfer of insurance risk is significant.

[4] Refer to Agenda Paper 2A *Loans that transfer significant insurance risk* for the February 2019 Board meeting. At its February 2019 meeting the Board tentatively decided to propose to amend the scope of IFRS 17 and IFRS 9 to enable an entity to account for a portfolio of insurance contracts that provide insurance coverage only for the settlement of the policyholder's obligation created by the contract applying either IFRS 17 or IFRS 9.

18. The staff note that such a credit card contract provides insurance coverage and combines payment services with the provision of credit. That insurance coverage differs from:

    (a) the insurance coverage that an entity issuing a credit card contract sells to its customers as an agent, such as travel insurance or roadside assistance provided by another party (the principal). A credit card contract that includes this insurance coverage would not be in the scope of IFRS 17.

    (b) the insurance coverage that an entity issuing a credit card contract sells to its customers as a principal and that meets the specified conditions for a fixed-fee service contract in paragraph 8 of IFRS 17 (see paragraph 7 of this paper). A credit card contract that includes this insurance coverage may be accounted for applying IFRS 15, rather than IFRS 17, applying paragraph 8 of IFRS 17.

    (c) the insurance coverage that an entity issuing a credit card contract provides for the settlement of the customer's obligation created by the contract, such as a waiver of the loan balance of the credit card if the customer dies. If this is the only insurance coverage provided by the credit card contract, the contract would be captured by the scope exclusion that the Board has tentatively decided to add to IFRS 17 at its February 2019 meeting for loans that transfer significant insurance risk.[4]

    (d) a mechanism sometimes referred to as 'chargeback'. A chargeback typically refers to situations where the customer is entitled to claim a refund of the amount paid by credit card (rather than an amount in excess of that amount as discussed in paragraph 13(c)(ii) of this paper). The customer typically addresses the claims to the entity issuing the credit card, which in turn puts in a request to the supplier's bank. However, in some cases there is no guarantee that the customer can recover the money through the chargeback. Even though the chargeback can be used in cases of goods not delivered or goods that are damaged, this does not mean that the entity issuing the credit card is jointly and severally liable with the supplier.

19. Applying paragraphs 10–13 of IFRS 17 only embedded derivatives, investment components, goods and non-insurance services can be assessed for separation from an insurance contract (see paragraph 9 of this paper). Thus, similar to loans that transfer significant insurance risk,[5] the loan component (a loan or a loan commitment) and the insurance component in such a credit card contract cannot be accounted for separately applying IFRS 17. As discussed in paragraph 14 of this paper, IFRS 17 differs from IFRS 4 which permits entities that issue such credit card contracts to account for the loan component applying IFRS 9.

20. The staff observe that:

    (a) many entities issuing credit card contracts that provide insurance coverage might not issue other contracts in the scope of IFRS 17; and

    (b) currently entities that issue the credit card contract discussed in paragraph 13 of this paper typically account for:

        (i) loans or loan commitments in credit card contracts (and any relevant interest revenue) applying IFRS 9;

        (ii) any insurance obligations applying IFRS 4, in a way similar to applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and

        (iii) any revenue for providing other services applying IFRS 15.

21. The staff think that this existing accounting for credit card contracts discussed in paragraph 13 of this paper provides useful information to users of financial statements about the components of these credit card contracts. IFRS 17 introduces changes to this existing accounting, which might impose costs and disruption for no significant benefits. Accordingly, the staff have considered a possible amendment to IFRS 17 that would:

    (a) exclude such credit card contracts from the scope of the Standard;

[5] Refer to Agenda Paper 2A *Loans that transfer significant insurance risk* for the February 2019 Board meeting.

(b) permit the continuation of existing accounting practices for those contracts and would therefore reduce IFRS 17 implementation costs for those entities; and

(c) not cause a significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements.

22. The staff have analysed the following approaches:

(a) Approach 1—Amending an existing scope exclusion in IFRS 17; and

(b) Approach 2—Developing a specific scope exclusion for credit card contracts.

Approach 1—Amending an existing scope exclusion in IFRS 17

23. The staff considered extending an existing scope exclusion in IFRS 17, specifically the scope exclusions relating to:

(a) warranties provided by a manufacturer, dealer or retailer; and

(b) fixed-fee service contracts.

Warranties provided by a manufacturer, dealer or retailer

24. With reference to the example of the credit card contract discussed in paragraph 13 of this paper, some stakeholders:

(a) observed that the entity and the supplier are jointly and severally liable in connection with the sale of the goods to the customer only because it is imposed by regulation;

(b) expressed the view that the insurance coverage provided by the entity issuing the credit card is similar to the assurance provided by a supplier that the goods purchased by the customer comply with the agreed-upon specifications—referred to as an assurance-type warranty in IFRS 15;[6] and

[6] As discussed in paragraph 6(a) of this paper, warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer are excluded from the scope of IFRS 17.

(c) have suggested the Board amend IFRS 17 to clarify that the scope exclusion in paragraph 7 of IFRS 17 for warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer also applies to entities that are jointly and severally liable with the manufacturer, dealer or retailer.

25. The staff think that the scope exclusion relating to warranties provided by a manufacturer, dealer or retailer in IFRS 17 might not fully apply to the insurance coverage provided by the credit card contract discussed in paragraph 13 of this paper. Paragraph BC89 of the Basis for Conclusions on IFRS 17 explains that a warranty provided by a manufacturer, dealer or retailer might provide a customer with assurance that the related product will function as the parties intended because it complies with agreed-upon specifications, or they might provide the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. The staff think that such a warranty refers to an obligation to replace or repair a defective product, rather than to an obligation to compensate the customer by making cash payments. Paragraph BC376 of the Basis for Conclusions on IFRS 15 explains that:

(a) the Board decided that an entity should recognise an assurance-type warranty as a separate liability to replace or repair a defective product; and

(b) an entity should recognise a warranty liability and corresponding expense when it transfers the product to the customer and the liability should be measured in accordance with IAS 37.

26. In addition, the staff think that extending the scope exclusion relating to warranties, as suggested by stakeholders in paragraph 24(c) of this paper, might exclude from the scope of IFRS 17 a large population of insurance contracts that provide a performance guarantee as envisaged in paragraph B26(f) of IFRS 17, such as contracts that compensate the holder if a manufacturer fails to perform a contractual obligation, including the construction of a building. The staff think that applying IFRS 15 to those contracts may result in a different accounting to that which would result from applying IFRS 17. Comparability between the accounting in IFRS 15 and in IFRS 17

is one of the aspects the Board considered when deciding to exclude warranties from the scope of IFRS 17 (see paragraph 6(a) of this paper).

27. The staff therefore do not recommend the Board amend IFRS 17 as suggested by some stakeholders in paragraph 24(c) of this paper.

Fixed-fee service contracts

28. The staff note that there are some similarities between the credit card contract discussed in paragraph 13 of this paper and a fixed-fee service contract. An entity can apply IFRS 15 instead of IFRS 17 to a fixed-fee service contract that meets the definition of an insurance contract if, and only if, the three conditions listed in paragraph 8 of IFRS 17 are met (see paragraph 7 of this paper).

29. In terms of similarities, the staff note that the credit card contract discussed in paragraph 13 of this paper:

(a) provides insurance coverage for a fixed fee—ie an annual fee, if any fee is charged by the entity to the customer; and

(b) either charges a fee to the customer that does not reflect an assessment of the insurance risk associated with the individual customer or does not charge any fee at all.

30. However, the staff also note the following differences:

(a) in the event of a supplier failure, the contract does not compensate the customer by providing services. The contract compensates the customer by making cash payments to the customer.

(b) the contract has as its primary purpose the provision of credit and payment services, rather than the provision of services.

(c) the insurance risk transferred by the contract arises from both the customer's use of payment services and the uncertainty over the amount of claims. As discussed in paragraph 13(c)(ii) of this paper the customer can claim an amount in excess of the amount paid using the credit card from the entity or from the supplier.

31. The staff have considered whether to amend the requirements in paragraph 8 of IFRS 17 for fixed-fee service contracts to enable an entity issuing such a credit card contract not to apply IFRS 17 to such a contract. However, the staff concluded that significant amendments to the requirements in paragraph 8 of IFRS 17 would be necessary because of the different characteristics of a credit card contract and a fixed-fee service contract. The nature of a credit card contract is to provide credit and payment services and to compensate the customer by making cash payments to the customer, whereas the main feature of a fixed-fee service contract is to provide services and to compensate the customer by providing services. The staff concluded that it would be more appropriate to develop a specific scope exclusion for credit card contracts.

32. The staff therefore do not recommend the Board amend the existing scope exclusion for fixed-fee service contracts in IFRS 17 to exclude the credit card contract discussed in paragraph 13 of this paper.

Approach 2—Developing a specific scope exclusion for credit card contracts

33. The staff note that it could be seen as inappropriate to exclude from the scope of IFRS 17 any credit card contract that provides insurance coverage. If a contract transfers significant insurance risk, the contract is an insurance contract and IFRS 17 was developed with the objective that entities issuing insurance contracts account for those contracts in a consistent way that faithfully represents those contracts.

34. However, the staff think that it could be justified to exclude some credit card contracts that provide insurance coverage from the scope of IFRS 17 in order to address the concerns and implementation challenges discussed in paragraphs 13–15 of this paper and to ease IFRS 17 implementation for some entities.

35. As discussed in paragraph 29 of this paper, similar to some fixed-fee service contracts that meet the definition of an insurance contract and that an entity can choose to account for applying IFRS 15, for the credit card contract discussed in paragraph 13 of this paper the compensation required by the entity does not reflect an assessment of the insurance risk associated with an individual customer.

36. The staff think that excluding from the scope of IFRS 17 credit card contracts that provide insurance coverage for which the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer would:

   (a) permit the continuation of the existing accounting practice discussed in paragraph 20(b) of this paper and therefore reduce IFRS 17 implementation costs for some entities. Amending IFRS 17 by permitting the continuation of the existing accounting practice would not require the Board to consider to amend the disclosure and transition requirements in IFRS Standards for such credit card contracts.

   (b) not result in a significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements. Other relevant IFRS Standards would apply to such credit card contracts and would provide relevant information about the components of those contracts to users of financial statements. Entities would continue to apply the existing accounting practice discussed in paragraph 20(b) of this paper.

37. Regarding the separation of components in a credit card contract that provides insurance coverage and that would be excluded from the scope of IFRS 17, the staff note that paragraph 7 of IFRS 15 states that:

   (a) a contract with a customer may be partially within the scope of IFRS 15 and partially within the scope of other IFRS Standards;

   (b) if the other Standards specify how to separate one or more parts of the contract, then an entity shall first apply the separation requirements in those Standards; and

   (c) if the other Standards do not specify how to separate one or more parts of the contract, then the entity shall apply IFRS 15 to separate the part (or parts) of the contract.

38. Accordingly, the staff think that an entity issuing a credit card contract that provides insurance coverage and that would be excluded from the scope of IFRS 17 would, for example, be in the scope of:

    (a) IFRS 9 for the loan or loan commitment (including the insurance elements) and any interest revenue charged if the customer does not settle the credit card balance in full by a specified date;[7]

    (b) IFRS 15 for revenue from contracts with customers for other services provided by the entity, such as access to airport lounges; and

    (c) IAS 37 if the contract in the scope of IFRS 15 is, or has become, onerous and in circumstances not covered by another IFRS Standard.

39. The staff considered whether to recommend amending IFRS 17 to permit, rather than require, an entity to apply IFRS 9 to credit card contracts that provide insurance coverage. The staff think that an option to apply either IFRS 17 or IFRS 9 could be justified if the Board wanted to enable an entity that mainly issues insurance contracts to apply IFRS 17 to credit card contracts that provide insurance coverage, permitting comparability with the other insurance contracts issued by the same entity. However, the staff concluded that such an option might result in diversity in practice in the absence of evidence that entities issuing credit card contracts that provide insurance coverage also issue other insurance contracts.

40. In addition to the example of the credit card contract discussed in paragraph 13 of this paper, which provide insurance coverage for a supplier failure, the staff acknowledge that the possible scope exclusion discussed in paragraph 36 of this paper might capture other types of credit card contracts that provide insurance coverage for which the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer, such as

[7] The staff note that, as explained in paragraph BC4.191 of the Basis for Conclusions on IFRS 9, IFRS 9 requires the holder of a financial asset to analyse the contractual terms to determine whether the asset gives rise to cash flows that are solely payments of principal and interest on the principal amount outstanding. The holder would not consider the payments that arise only as a result of regulation as cash flows in its analysis because that regulation and the related payments are not contractual terms of the financial instrument (see paragraph B4.1.13 of IFRS 9, Instrument E). For the example of the credit card contract discussed in paragraph 13 of this paper, the staff think that an entity would need to consider which IFRS Standard to apply to the insurance coverage provided, for example IAS 37.

travel insurance provided for a fixed fee. The staff note that the considerations in paragraph 35–38 of this paper would also be relevant to those other types of credit card contracts.

41. The staff recommend the Board amend IFRS 17 to exclude from the scope of the Standard credit card contracts that provide insurance coverage for which the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.

42. The staff think that such amendment would meet the criteria set by the Board at its October 2018 meeting because it would not:

 (a) result in a significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements, as discussed in paragraphs 36–38 of this paper; or

 (b) unduly disrupt implementation processes that are already under way—credit cards contracts are typically issued by entities that do not issue other contracts within the scope of IFRS 17 and thus are not focused on IFRS 17 implementation.

Question for Board members
Do you agree the Board should amend IFRS 17 to exclude from the scope of the Standard credit card contracts that provide insurance coverage for which the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer?