IFRS

STAFF PAPER

April 2019

IASB® meeting

Project	**Amendments to IFRS 17 *Insurance Contracts***
Paper topic	Sweep issues

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Purpose

1. This paper discusses additional stakeholder concerns relating to IFRS 17 *Insurance Contracts* which have arisen in the project on the amendments to IFRS 17, as follows:
   (a) effective date of proposed amendments to IFRS 17 (paragraphs 4–7 of this paper);
   (b) applying the option to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income (OCI) in the general model and using derivatives to mitigate financial risks (paragraphs 8–15 of this paper);
   (c) applying the option to disaggregate insurance finance income or expenses between profit or loss and OCI in the variable fee approach and applying the risk mitigation option (paragraphs 16–20 of this paper); and
   (d) reconciliations related to the liability for remaining coverage and the liability for incurred claims when cash flows are net settled (paragraphs 21–26 of this paper).

2. This paper also discusses a stakeholder concern relating to IFRS 9 *Financial Instruments* which relates to the restatement of comparative information when an entity initially applies IFRS 17 and IFRS 9 at the same time (paragraphs 27–35 of this paper).

Summary of staff recommendations

3. The staff recommend the International Accounting Standards Board (Board):
   (a) propose that the effective date of proposed amendments should be aligned with the effective date of IFRS 17, so that entities would be required to apply IFRS 17, and any proposed amendments, for annual periods beginning on or after 1 January 2022, and be permitted to apply IFRS 17 together with any proposed amendments, for earlier periods; and
   (b) retain the requirements in IFRS 17 (and IFRS 9) relating to the other issues in this paper.

Staff analysis

1—Effective date of proposed amendments to IFRS 17

Issue

4. The Board needs to propose an effective date for the proposed amendments.

Staff analysis and recommendation

5. The Board developed the proposed amendments, and set the timeline for finalising those amendments, to ease implementation process of IFRS 17. Therefore, the staff think that the effective date of the proposed amendments should align with the effective date of IFRS 17.

6. The staff considered whether the Board should permit entities to apply IFRS 17 (earlier than its mandatory effective date) without applying the proposed amendments, once they are finalised, given that IFRS 17 can be applied without the proposed amendments today. The staff think that allowing entities to implement the existing IFRS 17 requirements and then the amended requirements subsequently may impair comparability, add complexity for users of financial statements and would not be consistent with the Board's intention that the proposed amendments should ease implementation processes where possible. Therefore, the staff think that once the proposed amendments are finalised, entities should be permitted to early apply the amended Standard only.

7. Therefore, the staff recommend that the effective date of proposed amendments should be aligned with the effective date of IFRS 17, so that entities would be required to apply IFRS 17, and any proposed amendments, for annual periods beginning on or after 1 January 2022, and be permitted to apply IFRS 17 together with any proposed amendments, for earlier periods.

2—Applying the option to disaggregate insurance finance income or expenses between profit or loss and OCI in the general model and using derivatives to mitigate financial risks (paragraph 88(b) of IFRS 17)

Issue

8. Some stakeholders are concerned with accounting mismatches that could arise between:
   (a) the effect of financial risks in the measurement of insurance contracts applying the general model; and
   (b) derivatives an entity uses to mitigate those risks, which are measured at fair value through profit or loss (FVPL) applying IFRS 9.

9. Such accounting mismatches might occur when, applying paragraph 88(b) of IFRS 17, an entity chooses to disaggregate insurance finance income or expenses

between profit or loss and OCI (OCI option), while recognising all changes in the fair value of the derivatives in profit or loss.

10. Those stakeholders suggest the Board should amend the requirements of IFRS 17 to introduce a risk mitigation option for insurance contracts accounted for applying the general model. This option would permit an entity to recognise some or all of the effect of financial risks in profit or loss, instead of in OCI, in order to reduce accounting mismatches.

Staff analysis and recommendation

11. IFRS 17 allows an accounting policy choice between including all insurance finance income or expenses in profit or loss and applying the OCI option on a portfolio basis.

12. This issue only arises when an entity has *chosen* to apply this option to a portfolio. While this choice has to be made at a portfolio level an entity can minimise the accounting mismatches described by stakeholders by choosing to include all of the effect of changes in financial risks in profit or loss, where the entity will also recognise changes in the fair value of the derivatives.

13. In developing IFRS 17, the Board considered requests from stakeholders to create a hedge accounting solution for insurance contracts without direct participation features. However, the Board concluded that it would not be appropriate to develop a bespoke solution for all hedging activities for insurance contracts. The Board developed the risk mitigation option in the variable fee approach only to address a potential new mismatch created by variable fee approach itself.

14. Finally, the staff observe that IFRS 9 includes general hedge accounting requirements and IAS 39 *Financial Instruments: Recognition and Measurement* includes a macro hedge model that may enable entities to address some accounting mismatches.

15. Given the options available to entities and because the Board already considered this matter when developing IFRS 17, the staff recommend not developing a risk mitigation option for insurance contracts accounted for applying the general model for which an entity chooses to apply the OCI option.

3—Applying the option to disaggregate insurance finance income or expenses between profit or loss and OCI in the variable fee approach and applying the risk mitigation option (paragraphs 45(c)(ii), 88(b), 89(b) of IFRS 17)

Issue

16. Some stakeholders raised similar concerns to those included in issue 2 above, noting that if an entity chooses to apply the risk mitigation option and the OCI option it will experience the same accounting mismatches because:

    (a) the application of both the risk mitigation option and the OCI option would result in the effect of some changes in financial risks being recognised in OCI, consistent with the OCI on the underlying items; and

    (b) derivatives an entity uses to manage those risks are measured at FVPL applying IFRS 9.

17. This could be the case for example when an entity uses derivatives to mitigate the risk arising from a minimum return on investment guaranteed to the policyholder. Applying the risk mitigation option in the variable fee approach, changes in the fulfilment cash flows related to value of the guarantee would not adjust the contractual service margin. Applying the OCI option would result in those changes to be recognised in OCI, while the changes in the value of the derivatives are recognised in profit or loss.

Staff analysis and recommendation

18. The analysis provided with respect to issue 2 above applies to issue 3 as well. This is because applying the risk mitigation option results in an outcome similar to applying the general model for the risk that the entity mitigates by using derivatives.

19. In addition, applying the variable fee approach when holding the underlying items, entities can consider whether they:

    (a) apply the risk mitigation option to reduce the accounting mismatches between the derivatives and the insurance contracts; or

    (b) apply the OCI option and therefore recognise in profit or loss an amount of insurance finance income or expenses equal and opposite the income or expenses included in profit or loss on the underlying items held (hence the net income or expenses on insurance contracts and underlying items equals nil).

20. Thus, entities have available options to avoid accounting mismatches, depending on which information they regard as most important. Therefore, the staff recommend the Board not undertake any further action in this regard.

4—Reconciliations related to the liability for remaining coverage and the liability for incurred claims when cash flows are net settled (paragraph 100 of IFRS 17)

Issue

21. Some stakeholders noted that specific settlement agreements between reinsurers (the issuers of reinsurance contracts) and insurers (the holders of reinsurance contracts) often include extensive netting arrangements under which all incoming and outgoing payments between the parties are settled net. Similarly, in some relationships between insurers and brokers/managing agents, the broker/agent performs the contractual cash handling and the premiums and claims are settled net with the insurer for all contracts managed by that broker/agent (this could be various types of contracts).

22. Those stakeholders observe that for these types of arrangements specific payments such as premiums and claims cannot be assigned to contracts, and hence to groups of contracts, because cash systems are not linked to accounting systems and therefore providing disclosures that distinguish between the liability for incurred claims and the liability for remaining coverage, such as required by paragraph 100 of IFRS 17, will require extensive allocations of cash flows. Those stakeholders suggest that the Board should amend the requirements of IFRS 17 to exclude amounts payable and receivable from the scope of IFRS 17 and include them in the scope of IFRS 9.

Staff analysis and recommendation

23. The Board tentatively decided to amend the requirements of IFRS 17 with respect to the presentation of carrying amounts in the statement of financial position, so that they will relate to portfolios of insurance contracts rather than groups of insurance contracts.

24. At its December 2018 meeting, the Board rejected an amendment that would require measuring premiums receivable and claims payable separately from insurance contracts, because it would result in internal inconsistencies in IFRS 17. The principle of IFRS 17 recognises that a contract, and by extension a group of contracts, creates a single bundle of rights and obligations and reflects the Board’s view that accounting for the transaction as a whole provides useful information. Measuring premiums receivable and claims payable separately and differently from the corresponding obligations and rights is inconsistent with this principle. The staff think these views are still valid.

25. The staff observe that information about claims development, as required by paragraph 130 of IFRS 17, and about changes in the liability for incurred claims over the reporting period (separately from the liability for remaining coverage), as required by paragraph 100 of IFRS 17, provide useful information to users of financial statements regardless of whether the claims are settled directly by the entity, by others on its behalf, or net of premiums due.

26. Based on the analysis in paragraphs 23−25 of this paper, the staff recommend the Board not undertake any further action in this regard.

5—Restatement of comparative information when an entity initially applies IFRS 17 and IFRS 9 at the same time (paragraph C3 of IFRS 17 and paragraph 7.2.1 of IFRS 9)

Background—requirements in IFRS 17

27. Paragraph C3 of IFRS 17 requires an entity to apply IFRS 17 retrospectively unless impracticable, subject to some exceptions described in paragraphs C3(a) and C3(b) of IFRS 17.

28. IFRS 17 also requires an entity to present adjusted comparative information, applying the requirements of IFRS 17, for the period immediately before the date of initial application of IFRS 17. An entity may also present adjusted comparative information applying IFRS 17 for any earlier periods presented but is not required to do so.

Background—requirements in IFRS 9

29. Paragraph 7.2.1 of IFRS 9 requires an entity to apply IFRS 9 retrospectively, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors,* subject to some exceptions listed in that paragraph. Paragraph 7.2.1 of IFRS 9 prohibits an entity from applying IFRS 9 to items that have already been derecognised at the date of initial application of IFRS 9.

30. Paragraph 7.2.15 of IFRS 9 permits, but does not require, an entity to restate prior periods. An entity may restate prior periods if, and only if, it is possible without the use of hindsight.

Issue

31. A stakeholder says that an entity that initially applies IFRS 17 and IFRS 9 at the same time may wish to restate prior periods to reflect the requirements in IFRS 9. However, in this stakeholder's view, the requirement in paragraph 7.2.1 of IFRS 9 that prohibits entities from applying IFRS 9 to items that have already been derecognised may deter the entity from restating prior periods. According to the stakeholder, that is because this requirement would be burdensome to apply. In addition, the stakeholder believes there is no reason for not applying IFRS 9 to items that have already been derecognised. Accordingly, the stakeholder recommends the Board amend paragraph 7.2.1 of IFRS 9 to permit entities to apply IFRS 9 to items that have already been derecognised at the date of initial application of IFRS 9.

Staff analysis and recommendation

32. The staff note that the transition requirements in IFRS 9 and IFRS 17, including the requirements related to restating comparative periods, were subject to extensive deliberation and consultation by the Board. With regards to restating comparative information, the Board acknowledged that the requirements in IFRS 9 and IFRS 17 are different. Paragraph BC389 of the Basis for Conclusions on IFRS 17 specifically explains that those differences are the result of different circumstances that applied when the Board developed the respective transition requirements in IFRS 9 and IFRS 17. The staff think the stakeholder has not provided any new information

beyond that considered by the Board when it deliberated the transition requirements for IFRS 9 and IFRS 17.

33. The staff also note that most entities have already applied the transition requirements, including the requirement related to derecognised items, during their initial application of IFRS 9. Although IFRS 9 does not require restatement of prior periods, the requirement related to derecognised items was applicable to entities who chose to do so.

34. The staff observe that proposing any changes to IFRS 9, particularly with respect to the transition requirements, may risk unintended consequences. Given that insurers can mitigate some of these concerns by applying IFRS 9 for the first time before they apply IFRS 17 for the first time, the staff think that a change to the requirements of IFRS 9 is not required.

35. Accordingly, the staff recommend the Board not undertake any further action in this regard.

Question for Board members
Do you agree that with the staff recommendations for resolving the issues identified in this paper?