STAFF PAPER

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IASB® meeting

Project	**Amendments to IFRS 17 *Insurance Contracts***
Paper topic	Transition—Modified retrospective approach

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Purpose

1. This paper primarily discusses the application of the modified retrospective approach in the transition requirements in IFRS 17 *Insurance Contracts*. Specifically, it discusses the use of:

    (a) reasonable and supportable information; and

    (b) specified modifications.

2. Some of the topics discussed in this paper relate both to the modified retrospective approach and the fair value approach to transition to IFRS 17. Therefore, for those topics, this paper also discusses the fair value approach.

3. This paper does not discuss concerns and implementation challenges expressed by stakeholders about applying the level of aggregation requirements on transition to IFRS 17. This will be discussed at a future meeting of the International Accounting Standards Board (Board).

Summary of staff recommendations

4. The staff recommend the Board:

   (a) retain the requirements in IFRS 17 that an entity:

      (i) cannot use a specified modification in the modified retrospective approach to the extent that the entity has reasonable and supportable information to apply the related IFRS 17 requirement retrospectively; and

      (ii) can only use a specified modification in the modified retrospective approach when the entity has reasonable and supportable information to apply that modification.

   (b) does not amend IFRS 17 to permit an entity to develop its own modifications that it regards as consistent with the objective of the modified retrospective approach.

   (c) amend the transition requirements in IFRS 17 for a liability that relates to the settlement of claims incurred before an insurance contract was acquired as follows:

      (i) to add a specified modification to the modified retrospective approach to require an entity to classify such liabilities as a liability for incurred claims. Consistent with the other specified modifications, an entity would be permitted to use this specified modification only to the extent that it does not have reasonable and supportable information to apply a retrospective approach.

      (ii) to permit an entity applying the fair value approach to choose to classify such liabilities as a liability for incurred claims.

   (d) does not amend the specified modification in the modified retrospective approach related to the use of cash flows that are known to have occurred instead of estimating retrospectively cash flows that were expected to occur.

   (e) does not amend IFRS 17 to permit an entity to apply the specified modifications related to groups of insurance contracts without direct participation features to determine the contractual service margin for groups of contracts with direct participating features.

Structure of the paper

5. This paper provides:
   (a) an overview of the requirements in IFRS 17;
   (b) a summary of the Board's rationale for setting those requirements, including an overview of the Board's previous discussions; and
   (c) for each of the topics in paragraphs 1(a)−1(b) of this paper:
      (i) an overview of the concerns and implementation challenges expressed since IFRS 17 was issued; and
      (ii) the staff analysis, recommendations and questions for Board members.
6. Appendix A to this paper provides a diagram to illustrate the application of the IFRS 17 transition requirements to a group of insurance contracts.
7. Appendix B to this paper provides references to some of the specific requirements discussed in this paper.

IFRS 17 requirements

8. If it is impracticable[1] to apply a full retrospective approach to transition to IFRS 17 for a group of insurance contracts, an entity may choose to either apply the modified retrospective approach or the fair value approach for that group of insurance contracts.
9. The Board set the modifications in the modified retrospective approach in order to achieve the closest outcome to retrospective application possible using reasonable and supportable information available without undue cost or effort. The modified

[1] IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* defines applying a requirement as impracticable when the entity cannot apply it after making every reasonable effort to do so.

retrospective approach provides specified modifications for amounts needed for retrospective application, the measurement of which the Board thought would often be impracticable. These modifications allow an entity to:

(a) determine specified matters as at the transition date, instead of retrospectively applying IFRS 17 to determine those matters at initial recognition of a group of insurance contracts or date of a past event; and

(b) use specified proxies for some IFRS 17 requirements, for the purpose of determining the contractual service margin of a group of insurance contracts at the transition date.

10. An entity can use each of the specified modifications only:

(a) to the extent it does not have reasonable and supportable information to retrospectively apply the IFRS 17 requirements to which that modification relates. If the entity has reasonable and supportable information to retrospectively apply an IFRS 17 requirement, it must do so.

(b) if it has reasonable and supportable information to apply that modification. If the entity does not have such information needed to apply a modification, it is required to instead apply the fair value approach to transition for that group of insurance contracts.

11. Furthermore, if an entity is using a specified modification and some information that the entity would have used to retrospectively apply that IFRS 17 requirements is available without undue cost or effort, the entity cannot disregard that information.

The Board's rationale

12. In the development of IFRS 17, stakeholders noted that a full retrospective approach would often be impracticable, and acknowledged that any approach to estimate the residual margin (the term for the predecessor to the contractual service margin) for contracts in force at the date of transition would likely be costly. However, stakeholders also indicated that an inability to apply a retrospective approach could impair comparability between contracts written before and after the date of transition.

13. Although many entities may not have sufficient information for a fully retrospective application, the Board was told that in many cases entities may have much of the information needed, and that some entities may face only a small number of limitations on retrospective application. In such situations, more comparable information could be achieved if an entity were to be permitted to modify retrospective application only to the extent needed because it lacked some information to apply a fully retrospective approach.

14. Therefore, the Board decided to specify some modifications that are permitted only to the extent necessary because an entity does not have reasonable and supportable information to apply a specific IFRS 17 requirement retrospectively. The Board concluded that an entity should use the minimum modifications necessary in order to achieve the closest outcome to retrospective application that is possible.

Concerns and implementation challenges expressed since IFRS 17 was issued

15. Some stakeholders have said that it will often be impracticable for them to apply a full retrospective approach to transition to IFRS 17. Some of those stakeholders have said that they would like to use the modified retrospective approach to transition, rather than the fair value approach, because they think that applying IFRS 17 retrospectively to the extent possible will provide the most useful information about their business at the transition date and going forward. However, those stakeholders expressed the view that the modified retrospective approach is too restrictive, making it costly and burdensome to apply in practice. This paper considers separately stakeholder concerns relating to the use of:

    (a) reasonable and supportable information (paragraphs 16−29 of this paper); and

    (b) specified modifications (paragraphs 30−56 of this paper).

Reasonable and supportable information

Concerns and implementation challenges expressed since IFRS 17 was issued

16. Some stakeholders stated that it is difficult to interpret the term ‘reasonable and supportable information’. Those stakeholders have suggested that they may struggle to prove that the data they want to use can be demonstrated to be reasonable and supportable. Some of those stakeholders have also questioned the difference between ‘reasonable and supportable information’ and ‘reasonable and supportable information *available without undue cost or effort*’.

17. Some stakeholders have suggested amendments to IFRS 17 that they think would address their concerns. Those amendments are:

    (a) regarding paragraph C8 of IFRS 17—to permit an entity to use each specified modification in the modified retrospective approach even when the entity has reasonable and supportable information to retrospectively apply the IFRS 17 requirement that the modification relates to. Some stakeholders have suggested this amendment for all of the specified modifications. Other stakeholders have suggested this amendment for only some specified modifications.[2]

    (b) regarding paragraph C6 of IFRS 17—to permit an entity to use each specified modification in the modified retrospective approach even when the entity does not have reasonable and supportable information to apply that modification.

Staff analysis and recommendation

18. The staff observe that, generally, an entity would be expected to use information that is reasonable and supportable in the preparation of financial statements to meet the objective of providing useful information to users of financial statements.

19. When applying an accounting policy retrospectively, the information available may be more limited than it would be when applying an accounting policy prospectively. The modified retrospective approach to transition to IFRS 17 essentially provides

[2] Some stakeholders have suggested this amendment for only the requirements in paragraph C9 of IFRS 17 which relate to determining specified matters at the transition date.

entities with a hierarchy in terms of the information that is required to use that approach. That hierarchy is:

(a) if an entity has reasonable and supportable information to apply an IFRS 17 requirement retrospectively, it shall use that information to apply the requirement retrospectively.

(b) to the extent that an entity does not have reasonable and supportable information to apply an IFRS 17 requirement retrospectively, it shall use reasonable and supportable information to apply the specified modification which is a proxy for applying that IFRS 17 requirement retrospectively. In applying any modification, the entity cannot ignore any information that it would have used in applying the related IFRS 17 requirement retrospectively to the extent such information is available without undue cost or effort.

(c) if the entity does not have reasonable and supportable information to apply IFRS 17 retrospectively or to use the specified modifications it needs to, it cannot apply the modified retrospective approach for that group of insurance contracts and must use the fair value approach. An entity is not permitted to use a combination of the modified retrospective approach and the fair value approach for a group of insurance contracts.

20. To demonstrate the application of this hierarchy, this paragraph provides an example. In this example, it is impracticable for the entity to apply a full retrospective approach to transition for a group of insurance contracts it issued 10 years prior to the transition date. The entity is considering whether it could apply the modified retrospective approach. The entity has determined that it can apply all requirements in IFRS 17 retrospectively to the group of insurance contracts, except estimating the amount of future cash flows at the date of initial recognition. The entity has reasonable and supportable information to determine retrospectively the future cash flows as at five years prior to the transition date, but it cannot go as far back as 10 years. Consider two scenarios:

(a) the entity has reasonable and supportable information to apply the specified modification to estimate the future cash flows at initial recognition. In this scenario, the entity has the choice to apply either the modified retrospective approach or the fair value approach to the group of insurance contracts. If the entity chooses to apply the modified retrospective approach, the entity would be required to use the following proxy:

(i) determine retrospectively the future cash flows as at five years prior to the transition date; and

(ii) estimate *actual* cash flows to roll that amount back to the date of initial recognition.

(b) the entity does not have reasonable and supportable information to apply the specified modification to estimate the future cash flows at initial recognition. In this scenario, the entity is required to apply the fair value approach to the group of insurance contracts.

21. The staff acknowledge that determining whether information is reasonable and supportable when transitioning to IFRS 17 may require an assessment and careful consideration. The staff think that practice needs to develop in this area.

22. Some stakeholders have suggested that an entity should be permitted to use each specified modification even when the entity has reasonable and supportable information available to apply retrospectively the IFRS 17 requirement that modification relates to.

23. The staff acknowledge that this amendment could provide significant practical relief to entities transitioning to IFRS 17. However, the staff think that to allow an entity to ignore its ability to retrospectively apply specific requirements in IFRS 17 is not justified and would result in an unacceptable loss of useful information. Applying aspects of IFRS 17 retrospectively maximises comparability between contracts written before and after the date of transition, which is the objective of the modified retrospective approach.

24. Although the specified modifications aim to be proxies for applying IFRS 17 retrospectively, the staff observe that the Board only intended those proxies to be used when necessary, because the Board views the information provided by retrospectively applying IFRS 17 as being the most useful for users of financial statements. Furthermore, the Board developed the specified modifications in response to feedback that many entities may lack only some limited information to apply a full

retrospective approach. Allowing those entities to use specified modifications that are not necessary would be equivalent to permitting entities to make a number of choices.[3] Such choices would not be consistent with the objective of getting as close to retrospective application as possible. Allowing choices would further reduce the comparability between entities that are applying a full retrospective approach and entities that lack only limited information for applying a full retrospective approach.

25. Accordingly, the staff recommend the Board retain the requirements in IFRS 17 that an entity cannot use a specified modification in the modified retrospective approach to the extent that the entity has reasonable and supportable information to apply the related IFRS 17 requirement retrospectively.

26. Some stakeholders have suggested that an entity should be permitted to use each specified modification in the modified retrospective approach even when the entity does not have reasonable and supportable information to apply that modification. The staff think that it would be inappropriate for the Board to allow an entity to apply a specified modification without having reasonable and supportable information to do so.

27. Accordingly, the staff recommend the Board retain the requirements in IFRS 17 that an entity can only use a specified modification in the modified retrospective approach when the entity has reasonable and supportable information to apply that modification.

28. The staff observe that some stakeholders have questioned the use of the term 'reasonable and supportable information *available without undue cost or effort*' which is used in the objective of the modified retrospective approach in paragraph C6 of IFRS 17. The staff explain the use of this term below:

    (a) the Board set the modifications in the modified retrospective approach in order to achieve the closest outcome to retrospective application possible using reasonable and supportable information available without undue cost or effort.

[3] As an example, an entity applying the modified retrospective approach makes some assessments at inception or initial recognition using information available at transition date in absence of reasonable and supportable information that that can be used to make these assessments at inception or initial recognition (paragraph C9 of IFRS 17). Removing the reference to the use of reasonable and supportable information would effectively allow an entity a choice between making these assessments at inception or initial recognition and the transition date. Some stakeholders have suggested the Board should amend IFRS 17 to allow this choice.

Accordingly, the Board developed modifications for requirements in IFRS 17 for which it thought it would be likely that retrospective application would be impracticable and set the requirements in paragraph C6(a)−C6(b) of IFRS 17.

(b) applying paragraph C6(a) of IFRS 17, an entity shall use specified modifications only to the extent it has reasonable and supportable information to do so. Although the term ‘available without undue cost or effort’ is not used in paragraph C6(a) of IFRS 17, the Board expected that, by nature, the reasonable and supportable information needed to apply a specified modification would often likely be easier and less costly to obtain than the reasonable and supportable information needed to retrospectively apply IFRS 17. The wording of paragraph C6(a) of IFRS 17 allows an entity to devote as much cost and effort as it wishes to obtain the information. If the entity cannot get such information, it must apply the fair value approach to the group of insurance contracts.

(c) applying paragraph C6(b) of IFRS 17, an entity shall maximise the use of information that would have been used to apply a fully retrospective approach but need only use information available without undue cost or effort. The staff expect that, although some information required to retrospectively apply IFRS 17 might require significant cost or effort to obtain, some other information might be available without undue cost or effort.

(d) the term ‘available without undue cost or effort’ is not relevant in applying paragraph C8 of IFRS 17. That paragraph requires an entity to apply IFRS 17 retrospectively to the extent that it has reasonable and supportable information to do so.

29. The staff observe that generally stakeholders have not expressed concerns specifically relating to paragraph C6(b) of IFRS 17 on maximising the use of information that would have been used to apply a full retrospective approach. The staff think that requirement is consistent with the other requirements discussed in paragraphs 20−27 of this paper and like those requirements, is fundamental to achieving the objective of the modified retrospective approach.

Questions for Board members

Do you agree the Board should retain the requirements in IFRS 17 that an entity:

(a) cannot use a specified modification in the modified retrospective approach to the extent that the entity has reasonable and supportable information to apply the related IFRS 17 requirement retrospectively; and

(b) can only use a specified modification in the modified retrospective approach when the entity has reasonable and supportable information to apply that modification.

Specified modifications

Concerns and implementation challenges expressed since IFRS 17 was issued

30. Some stakeholders expressed the view that the modified retrospective approach is as restrictive, or more restrictive, than a full retrospective approach because they think the existence of specified modifications prohibits them from making estimates that are necessary to retrospectively apply IFRS 17 to those requirements to which the entity does not apply the specified modifications. Some stakeholders also think that they are prohibited from using estimates in applying the specified modifications.

31. Some stakeholders expressed the view that the modified retrospective approach does not provide sufficient specified modifications. Those stakeholders are concerned that they are required to apply a fully retrospective approach to aspects of the requirements not covered by a specified modification and that this would be difficult and costly to apply in practice. Some stakeholders have suggested the Board amend IFRS 17 to permit the use of a principle-based approach that will allow entities to develop their own modifications that they think are consistent with the objective of the modified retrospective approach.

32. Some stakeholders have suggested the Board amend IFRS 17 to add further specified modifications that they think will address their concerns. Those amendments are explained below:[4]

    (a) *Contracts acquired in their settlement period before transition*— in some cases, it is necessary to distinguish between contracts issued by an entity and contracts acquired by an entity. Some stakeholders noted that, in some cases, when an entity acquires insurance contracts in a portfolio transfer, the contracts acquired are managed in the same system as those that have been issued by the entity. Those contracts may be managed in a manner that makes it impracticable to distinguish between them. This may also be the case in business combination transaction, but may be less common if the acquired entity continues to manage the contracts it had issued in its separate systems. Some stakeholders noted in particular that their claims management systems manage all claims regardless of whether they relate to contracts the entity issued or they are claims acquired. Some stakeholders explained that it may be impracticable to classify claims on contracts the entity *issued* as a liability for incurred claims and claims *acquired* as a liability for remaining coverage. They observed that while the modified retrospective approach provides a number of specified modifications related to classification of contracts, none of them cover the classification of fulfilment cash flows as a liability for remaining coverage or a liability for incurred claims. Similar concerns have been raised with respect to the fair value approach.

    (b) *Cash flows that are known to have occurred*—some stakeholders expressed the view that applying the modification in paragraphs C12 of IFRS 17 would mean that they would need to identify actual cash flows that are known to have occurred. They regarded the need to identify the actual cash flows that are known to have occurred to be as demanding, or more demanding, as the full retrospective approach. Some stakeholders have suggested the Board amend IFRS 17 to allow the use of reasonable and supportable information to determine cash flows that are known to have occurred.

[4] Appendix B to this paper includes references to the relevant requirements for each topic.

(c) *Insurance contracts with direct participation features*—some stakeholders have suggested the Board amend the requirements in IFRS 17 to permit an entity to apply the specified modifications related to groups of insurance contracts without direct participation features (general model contracts), in determining the contractual service margin[5] for groups of contracts with direct participating features (variable fee approach (VFA) contracts).

Staff analysis and recommendation

33. This analysis considers each of the amendments to IFRS 17 suggested by stakeholders in paragraphs 31−32 of this paper separately:

(a) permitting entities to develop their own additional modifications (paragraphs 34−39 of this paper);

(b) contracts previously acquired in their settlement period (paragraphs 40−45 of this paper);

(c) cash flows that are known to have occurred (paragraphs 46−50 of this paper); and

(d) insurance contracts with direct participation features (paragraphs 51−56 of this paper).

Permitting entities to develop their own additional modifications

34. When an entity applies a requirement retrospectively, it may be necessary to make estimates.[6] When the entity cannot estimate an amount retrospectively, the specified modifications allow the entity to instead estimate a proxy for the retrospective determination of that amount. The objective of applying those proxies is to achieve what the Board thinks is the closest outcome to retrospective application possible using reasonable and supportable information available without undue cost or effort. If an entity was permitted to apply further unspecified modifications, those additional proxies would move the outcome further away from a full retrospective approach. The staff think that if an entity were permitted to make unspecified modifications, the

[5] or loss component of the liability for remaining coverage.
[6] Paragraph 51 of IAS 8 discusses making estimates when retrospectively applying an accounting policy.

outcome could risk moving so far away from full retrospective application that it no longer meets the objective of approximating full retrospective application. Therefore, the benefits of the modified retrospective approach would be lost.

35. Therefore, the staff recommend the Board does not amend IFRS 17 to permit an entity to develop its own modifications that the entity regards as consistent with the objective of the modified retrospective approach.

36. The staff think that in the light of stakeholder feedback in paragraph 30 of this paper, if the Board decides not to permit entities to develop their own unspecified modifications, it may be helpful to stakeholders if the Board were to explain in the Basis for Conclusions on IFRS 17 that the existence of specified modifications in the modified retrospective approach does not prohibit an entity from:

   (a) making estimates that are necessary in retrospectively applying an accounting policy as described in paragraph 51 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; or

   (b) similarly, making estimates when applying a specified modification in the modified retrospective approach.

37. The staff note that this recommendation does not preclude the Board making additional specified modifications in IFRS 17, which it regards as acceptable proxies to full retrospective application. The staff think that there is little risk of unduly disrupting implementation already underway from adding specified modifications to the modified retrospective approach that:

   (a) the Board thinks would meet the objective of the approach; and

   (b) an entity can use only to the extent that it cannot retrospectively apply IFRS 17 to specific requirements.

38. Rather, doing so might significantly reduce implementation costs and simplify IFRS 17 implementation for many entities. However, any change to the objective of the modified retrospective approach or the introduction of additional optionality may:

   (a) result in the approach no longer being a proxy for a full retrospective approach; and

   (b) risk the loss of useful information to users of financial statements.

39. Paragraphs 40−56 of this paper consider the extent that the benefit of providing additional specified modifications could outweigh the costs of the additional complexity and the potential loss of useful information.

Contracts acquired in their settlement period before transition

40. Paragraphs B1−B3 of Appendix B to this paper set out the requirements in IFRS 17 relating to contracts in their settlement period acquired by an entity in a business combination. Those requirements specify that an entity classifies the liability that relates to settling claims for insured events as a liability for remaining coverage, if the insured event occurred before the transaction date.

41. The measurement of a liability for incurred claims at transition to IFRS 17 comprises estimates of the present value of future cash flows and an explicit risk adjustment for non-financial risk at that date. This measurement reflects only circumstances at the measurement date and therefore does not require the use of any specified modification on transition.

42. In contrast, the measurement of a liability for remaining coverage includes a contractual service margin. Both the modified retrospective approach and the fair value approach specify requirements for determining the contractual service margin. However, neither approach to transition addresses the classification of amounts as a liability for remaining coverage or liability for incurred claims.[7]

43. The staff observe that for contracts that an entity issues, it is unlikely that the entity would have insufficient information to determine the classification as either a liability for remaining coverage or a liability for incurred claims. However, as explained by stakeholders in paragraph 32(a) of this paper, in some circumstances it may be impracticable for entities to make this assessment when it has acquired insurance contracts before the transition date. This is because, due to the way entities often manage claims, it is often impractical to distinguish between claims arising from:

(a) insurance contracts the entity issued;

[7] Both transition approaches cover other assessments at initial recognition which are applicable for insurance contracts acquired—for example, how to identify groups of insurance contracts and whether contracts meet the definition of an insurance contract with direct participation features.

(b) insurance contracts the entity acquired—that occurred before the transaction date; and

(c) insurance contracts the entity acquired—that occurred after the transaction date.

The staff think that this concern is valid and note that it is relevant for both the modified retrospective and the fair value approach.

44. Therefore, the staff recommend the Board amend the transition requirements in IFRS 17 for a liability that relates to the settlement of claims incurred before an insurance contract was acquired as follows:

(a) to add a specified modification to the modified retrospective approach to require an entity to classify such liabilities as a liability for incurred claims. Consistent with the other specified modifications, an entity would be permitted to use this specified modification only to the extent that it does not have reasonable and supportable information to apply a retrospective approach.

(b) to permit an entity applying the fair value approach to choose to classify such liabilities as a liability for incurred claims. Applying the fair value approach, an entity is permitted to make choices regarding specified aspects of the requirements.

45. The staff think that the amendments discussed in paragraph 44 of this paper will address stakeholder concerns and will support implementation processes already underway.

Cash flows that are known to have occurred

46. Paragraph B4 in Appendix B to this paper sets out the specified modification for determining future cash flows at the date of initial recognition of a group of insurance contracts.

47. The staff think it is not necessary to amend paragraph C12 of IFRS 17 to state that an entity can use reasonable and supportable information when determining cash flows that are known to have occurred. The staff note that the Board previously discussed similar concerns during its November 2016 meeting and noted that paragraph 51 of IAS 8 specifically allows for the use of estimates in retrospective application. That paragraph states that making such estimates is potentially more difficult when

retrospectively applying an accounting policy because of the period of time that might have passed since the transaction or event being measured.

48. In addition, paragraph C6 of IFRS 17 requires the use of reasonable and supportable information when applying the modified retrospective approach. Therefore, if data on actual cash flows has not been collected or has been collected at a different level than required, an entity is required to use reasonable and supportable information to estimate those amounts.

49. The staff recommend the Board does not amend paragraph C12 of IFRS 17 with respect to cash flows that are known to have occurred.

50. The staff note that this stakeholder concern is related to the more general stakeholder concern in paragraph 30 of this paper. Therefore, stakeholders with this concern may also find it helpful if the Board were to include in the Basis for Conclusions on IFRS 17 the explanation in paragraph 36 of this paper.

Insurance contracts with direct participation features

51. Paragraphs B5−B6 of Appendix B of this paper set out the specified modifications in IFRS 17 for insurance contracts with direct participation features (VFA contracts). In such contracts, the contractual service margin is adjusted for:

    (a) the entity's share of the changes in the fair value of the underlying items; and

    (b) the change in the effect of the time value of money and financial risk not arising from the underlying items (for example, the effect of financial guarantees).

52. In addition, the contractual service margin for VFA contracts is adjusted for the same adjustments (other than those described in paragraph 51 of this paper) as for insurance contracts without direct participation features (general model contracts).

53. The staff note that the specified modification for VFA contracts are intended to enable entities to determine directly the contractual service margin at transition date. This is possible because of the extent to which the contractual service margin is remeasured in the VFA approach. Thus, the contractual service margin for VFA contracts at the transition date is calculated as the difference between the total fair value of the

underlying items at that date minus the fulfilment cash flows at that date, with some adjustments for amounts that occurred before the transition date.

54. In contrast, the specified modifications for general model contracts are designed to help entities to first estimate the contractual service margin at initial recognition of contracts and then to roll forward the contractual service margin to determine the contractual service margin on the transition date. These specified modifications relate to estimates of cash flows, discount rates and the risk adjustment for non-financial risk.

55. The staff therefore think it is highly unlikely that applying the specified modifications applicable to general model contracts to VFA contracts would provide an outcome that is closer to the outcome that would result from applying the transition requirements in IFRS 17 for VFA contracts.

56. The staff recommend the Board does not amend IFRS 17 to permit an entity to apply the specified modifications related to groups of insurance contracts without direct participation features to determine the contractual service margin for groups of contracts with direct participating features.

Questions for Board members

Do you agree the Board should:

(a) not amend IFRS 17 to permit an entity to develop its own modifications that it regards as consistent with the objective of the modified retrospective approach.

(b) amend the transition requirements in IFRS 17 for a liability that relates to the settlement of claims incurred before an insurance contract was acquired as follows:

   (i) to add a specified modification to the modified retrospective approach to require an entity to classify such liabilities as a liability for incurred claims. Consistent with the other specified modifications, an entity would be permitted to use this specified modification only to the extent that it does not have reasonable and supportable information to apply a retrospective approach.

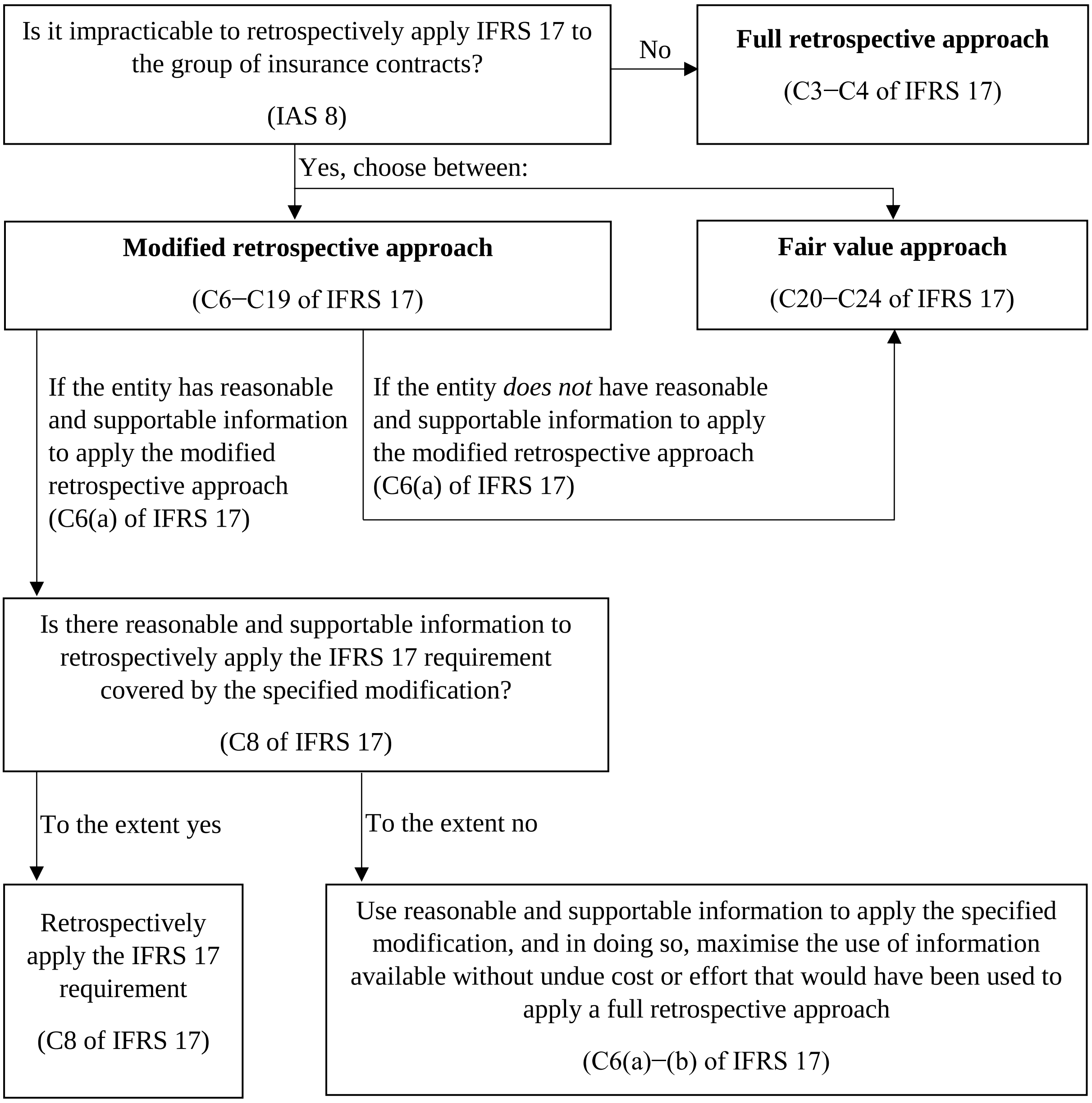
(ii) to permit an entity applying the fair value approach to choose to classify such liabilities as a liability for incurred claims.

(c) does not amend the specified modification in the modified retrospective approach related to the use of cash flows that are known to have occurred instead of estimating retrospectively cash flows that were expected to occur.

(d) does not amend IFRS 17 to permit an entity to apply the specified modifications related to groups of insurance contracts without direct participation features to determine the contractual service margin for groups of contracts with direct participating features.

Appendix A—Application of the transition requirements in IFRS 17 to a group of insurance contracts

A1. This diagram illustrates the application of the IFRS 17 transition requirements to a group of insurance contracts as set out in paragraphs C3−C24 of IFRS 17.



Appendix B—IFRS 17 requirements discussed in this paper

Contracts acquired in their settlement period before transition

B1. Contracts acquired in a business combination within the scope of IFRS 3 *Business Combinations* or a portfolio transfer are accounted for applying IFRS 17 as if the entity has issued them on the transaction date.

B2. When an entity *issues* an insurance contract and an insured event occurs, the liability that relates to settling claims for that insured event is classified as a liability for incurred claims. In contrast, when an entity *acquires* insurance contracts in their claims settlement period, the liability that relates to settling claims for insured events which occurred before the transaction date is classified as a liability for remaining coverage. For the entity that has acquired those contracts, the insured event is the determination of the ultimate cost of the claims.

B3. At its December 2018 meeting, the Board tentatively decided not to amend the requirements in IFRS 17 relating to the determination of the insured event for insurance contracts acquired.

Cash flows that are known to have occurred

B4. Paragraph C12 of IFRS 17 includes a specified modification for determining future cash flows at the date of initial recognition of a group of insurance contracts, as follows:

> To the extent permitted by paragraph C8 [of IFRS 17], an entity estimate future cash flows at the date of initial recognition of a group of insurance contracts as the amount of the future cash flows at the transition date (or earlier date, if the future cash flows at that earlier date can be determined retrospectively, applying paragraph C4(a) [of IFRS 17], adjusted by the cash flows that are known to have occurred between the date of initial recognition of a group of insurance contracts and the transition date (or earlier date]. The cash flows that are known to have occurred include cash flows resulting from contracts that ceased to exist before the transition date.

Insurance contracts with direct participation features

B5. Paragraph C17 of IFRS 17 sets out the specified modification available for groups of insurance contracts with direct participation features in determining the contractual service margin or loss component on transition to IFRS 17, as follows:

> C17 To the extent permitted by paragraph C8 [of IFRS 17], for contracts with direct participation features an entity shall determine the contractual service margin or loss component of the liability for remaining coverage at the transition date as:
>
> (a) the total fair value of the underlying items at that date; minus
>
> (b) the fulfilment cash flows at that date; plus or minus
>
> (c) an adjustment for:
>
> (i) amounts charged by the entity to the policyholders (including amounts deducted from the underlying items) before that date.
>
> (ii) amounts paid before that date that would not have varied based on the underlying items.
>
> (iii) the change in the risk adjustment for non-financial risk caused by the release from risk before that date. The entity shall estimate this amount by reference to the release of risk for similar insurance contracts that the entity issues at the transition date.
>
> (d) if (a)–(c) result in a contractual service margin—minus the amount of the contractual service margin that relates to services provided before that date. The total of (a)–(c) is a proxy for the total contractual service margin for all services to be provided under the group of contracts, ie before any amounts that would have been recognised in profit or loss for services provided. The entity shall estimate the amounts that would have been recognised in profit or loss for services provided by comparing the remaining coverage units at the transition date with the coverage units provided under the group of contracts before the transition date; or
>
> (e) if (a)–(c) result in a loss component—adjust the loss component to nil and increase the liability for remaining coverage excluding the loss component by the same amount.

B6. Paragraphs C11−C16 of IFRS 17 set out specified modifications that are available for groups of insurance contracts without direct participation features in determining the contractual service margin or loss component on transition to IFRS 17, as follows:

> C11 To the extent permitted by paragraph C8 [of IFRS 17], for contracts without direct participation features, an entity shall determine the contractual service margin or loss component of the liability for remaining coverage (see paragraphs 49–52 [of IFRS 17]) at the transition date by applying paragraphs C12–C16 [of IFRS 17].
>
> C12 To the extent permitted by paragraph C8 [of IFRS 17], an entity shall estimate the future cash flows at the date of initial recognition of a group of insurance contracts as the amount of the future cash flows at the transition date (or earlier date, if the future cash flows at that earlier date can be determined retrospectively, applying paragraph C4(a) [of IFRS 17]), adjusted by the cash flows that are known to have occurred between the date of initial recognition of a group of insurance contracts and the transition date (or earlier date). The cash flows that are known to have occurred include cash flows resulting from contracts that ceased to exist before the transition date.
>
> C13 To the extent permitted by paragraph C8 [of IFRS 17], an entity shall determine the discount rates that applied at the date of initial recognition of a group of insurance contracts (or subsequently):
>
> (a) using an observable yield curve that, for at least three years immediately before the transition date, approximates the yield curve estimated applying paragraphs 36 [of IFRS 17] and B72–B85 [of IFRS 17], if such an observable yield curve exists.
>
> (b) if the if the observable yield curve in paragraph (a) does not exist, estimate the discount rates that applied at the date of initial recognition (or subsequently) by determining an average spread between an observable yield curve and the yield curve estimated applying paragraphs 36 [of IFRS 17] and B72–B85 [of IFRS 17], and applying that spread to that observable yield curve. That spread shall be an average over at least three years immediately before the transition date.

C14 To the extent permitted by paragraph C8 [of IFRS 17], an entity shall determine the risk adjustment for non-financial risk at the date of initial recognition of a group of insurance contracts (or subsequently) by adjusting the risk adjustment for non-financial risk at the transition date by the expected release of risk before the transition date. The expected release of risk shall be determined by reference to the release of risk for similar insurance contracts that the entity issues at the transition date.

C15 If applying paragraphs C12–C14 [of IFRS 17] results in a contractual service margin at the date of initial recognition, to determine the contractual service margin at the date of transition an entity shall:

(a) if the entity applies C13 [of IFRS 17] to estimate the discount rates that apply on initial recognition, use those rates to accrete interest on the contractual service margin; and

(b) to the extent permitted by paragraph C8 [of IFRS 17], determine the amount of the contractual service margin recognised in profit or loss because of the transfer of services before the transition date, by comparing the remaining coverage units at that date with the coverage units provided under the group of contracts before the transition date (see paragraph B119 [of IFRS 17]).

C16 If applying paragraphs C12–C14 results in a loss component of the liability for remaining coverage at the date of initial recognition, an entity shall determine any amounts allocated to the loss component before the transition date applying paragraphs C12–C14 and using a systematic basis of allocation.