STAFF PAPER

November 2016

IASB Meeting

Project	**Insurance Contracts**		
Paper topic	Cover Note		
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Purpose of this paper

1. The papers for this meeting summarise the findings from the external testing of a draft of IFRS 17 *insurance Contracts* (draft IFRS 17), and address the issues arising from that external testing that the staff recommend the Board considers further. This cover note provides:

   (a) an update on the status of the insurance contracts project;

   (b) an overview of the agenda papers that will be discussed at the November meeting of the International Accounting Standards Board (the Board); and

   (c) an outline of the next steps in the process.

2. The appendix provides an overview of the key requirements of IFRS 17.

Status of the insurance contracts project

3. The Board completed its redeliberations on the 2013 Exposure Draft *Insurance Contracts* and granted the staff permission to begin the balloting process for the forthcoming insurance contracts Standard at its February 2016 meeting. The Due Process Oversight Committee reviewed the insurance contracts project's life-cycle review at the May 2016 meeting of Trustees of IFRS Foundation. In its June 2016 meeting the Board discussed narrow scope issues that have arisen in the drafting process of the insurance contracts Standard.

4. Since the June 2016 meeting the staff have:

   (a) received input from Board members on a complete first pre-ballot draft of IFRS 17; and

   (b) undertaken external testing of draft IFRS 17 as described in Agenda Paper 2A.

Overview of the November Board meeting papers

5. The papers for this meeting address the issues that have arisen following the feedback received from the external testing and in the drafting process of draft IFRS 17. This cover note summarises the following issues in those papers.

   (a) Agenda Paper 2A *Methodology - external testing of draft IFRS 17* sets out the methodology used for the external testing of draft IFRS 17. This paper is provided for information and the Board is not asked for decisions.

   (b) Agenda Paper 2B *Results - external testing of draft IFRS 17* discusses the findings from the external testing of draft IFRS 17. This paper is provided for information and the Board is not asked for decisions.

   (c) Agenda Paper 2C *Level of aggregation* considers a possible response to the feedback received on the level of aggregation in the external review of draft IFRS 17.

   (d) Agenda Paper 2D *Experience adjustments* considers whether the requirements in draft IFRS 17 on changes to the carrying amount of the contractual service margin for experience adjustments should be amended.

   (e) Agenda Paper 2E *Transition issues* considers a possible response to the issues relating to transition that have been identified in the external review draft of IFRS 17.

   (f) Agenda Paper 2F *Risk Mitigation* discusses feedback from test participants about the requirements in paragraph B104 draft IFRS 17. Those requirements relate to accounting for the effects of financial risk when an entity applies the variable fee approach and mitigates that risk with a derivative.

(g) Agenda Paper 2G *Other sweep issues* summarises issues that have arisen in the drafting process and external testing (ie sweep issues) that are not addressed in the other papers at the November 2016 Board meeting together with the staff's proposed response.

(h) Agenda Paper 2H *Mandatory effective date of IFRS 17* asks the Board to specify the mandatory effective date for IFRS 17 *Insurance Contracts*, assuming that the Board issues the Standard in the first half of 2017.

Next steps

6. Following the decisions made at the November 2016 Board meeting the staff will continue with the drafting process to:

   (a) reflect the decisions made in the November 2016 meeting in a revised draft of IFRS 17; and

   (b) ask selected external parties to perform a fatal flaw review of an updated draft of IFRS 17.

7. The staff expects to issue IFRS 17 in the first half of 2017.

Appendix: Overview of IFRS 17

A1. The Board is developing a new IFRS Standard for insurance contracts, IFRS 17 *Insurance Contracts*. The Standard sets out the principles that an entity needs to apply in order to report information about insurance contracts that it issues and reinsurance contracts that it acquires.[1]

A2. IFRS 17 is being developed because IFRS Standards do not address how to measure insurance contracts. As a result, insurers used a wide range of insurance accounting practices for reporting on a key aspect of their business activity. The different accounting treatment across jurisdictions and products made it difficult for investors and analysts to understand and compare insurers' results. Insurance contracts often cover long-term and complex risks that are difficult to reflect in the measurement of insurance contracts. In addition, insurance contracts are not typically traded in markets and may include a significant savings component, posing further measurement challenges. Some previous insurance accounting practices did not adequately reflect the true underlying financial positions and performance of these insurance contracts. To address these issues, the Board started a project to make insurance accounting practices consistent across jurisdictions and insurers' financial reports more relevant and transparent. IFRS 17 would complete this project.

Key requirements of IFRS 17

Measurement

A3. An insurance contract issued by an entity requires the entity to provide insurance coverage in exchange for consideration. The liability (or asset) recognised for a group of insurance contracts is measured at:

(a) a risk-adjusted present value of the future cash flows (that risk-adjusted present value is described in this Standard as the *fulfilment cash flows*); and

[1] In this document the term 'company' refers to an entity that prepares financial statements applying IFRS Standards. The term 'insurer' or 'insurance company' refers to an entity that issues insurance contracts as defined in IFRS 17.

(b) an amount representing the unearned profit in the group (described in this Standard as the *contractual service margin*).

A4. The fulfilment cash flows include all available information in a way that is consistent with observable market information. They are updated at the end of each reporting period using current assumptions.

A5. The contractual service margin is updated to reflect changes in estimates of future profitability and the effect of the time value of money, and is reduced each period to reflect the profit earned as insurance coverage is provided.

A6. IFRS 17 distinguishes insurance contracts with direct participation features and insurance contracts with no direct participation features. Different changes in estimates are regarded as related to future profitability for the two types of contracts and the updating of the contractual service margin differs accordingly.

Components of the carrying amount of the group of insurance contracts

A7. For the purposes of determining revenue and expenses, the total carrying amount of the group of insurance contracts (ie the fulfilment cash flows plus the contractual service margin) has the following components:

(a) a liability for remaining coverage, being the portion of the fulfilment cash flows that relates to coverage that will be provided under the contract in future periods, plus the remaining contractual service margin, if any. If the group is onerous, there is no contractual service margin and the liability for remaining coverage can be analysed as:

(i) a loss component; and

(ii) the liability for remaining coverage excluding the loss component.

(b) a *liability for incurred claims*, being the fulfilment cash flows for claims and expenses already incurred but not yet paid.

Presentation

A8. Changes in the measurement of the components described in paragraph A7 lead to the recognition of the following income and expenses:

(a) insurance contract revenue, at an amount equal to the reduction in the liability for remaining coverage that arises from the provision of insurance contract services in the period. That amount depicts the consideration for the insurance coverage provided in the period.

(b) claims and expenses, being the change in the liability for incurred claims that arises from claims and expenses incurred in the period and changes in the estimate of claims and expenses incurred in previous periods.

(c) losses on groups of onerous contracts, and any reversals of such losses.

(d) insurance finance income and expenses, being the effect of the time value of money and changes in assumptions that give rise to *financial risk* on the total insurance contract liability.

A9. Some insurance contracts contain an *investment component*. If that component is distinct, an entity accounts for it as a separate financial instrument. If that component is not distinct, an entity:

(a) includes it in the measurement of the insurance contract liability; but

(b) treats the amounts received for that component as deposit receipts and the payments relating to that component as repayments of deposits. Accordingly the entity excludes those amounts from consideration and revenue when applying paragraph (a) and from incurred claims when applying paragraph (b).