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PRESENTER	SUE LLOYD	

Effects Analysis: Presentation on the Insurance Contracts Standard

Purpose

1. This paper provides the Due Process Oversight Committee (DPOC) with information about how the Effects Analysis for the forthcoming insurance contracts Standard meets the requirements of the Due Process Handbook and the recommendations of the Effects Analysis Consultative Group.

Introduction

2. The Board expects to issue a new insurance contracts Standard, called IFRS 17 *Insurance Contracts*, in the coming months.[1] At that time the Board will also publish an Effects Analysis describing:

   (a) the likely effects of the changes to the accounting requirements for insurance contracts; and

   (b) the work that the Board has undertaken throughout the project to assess those effects.

3. The Effects Analysis on IFRS 17 follows the methodology of Effects Analysis in the Due Process Handbook[2] which call for consideration of:

   (a) how relevant activities will be reported in the financial statements of those applying IFRS Standards;

[1] The new Standard will replace IFRS 4 *Insurance Contracts* from 1 January 2021.
[2] Examples of the issues—listed in paragraph 3.75 of the Due Process Handbook— to be considered in forming the Board's judgement on the evaluation of the likely effects of a new Standard are summarised within points (a)–(f).

(b) how comparability of financial information will be affected both between different reporting periods for the same entity and between different entities in a particular reporting period;

(c) how the ability of users of financial statements to assess the amount, timing and uncertainty of an entity's future cash flows, as well as the entity's financial position and performance, will be affected;

(d) whether better economic decision-making will be possible as a result of improved financial reporting;

(e) how compliance costs for preparers will be affected, both on initial application and on an ongoing basis; and

(f) how costs of analysis for users of financial statements will be affected.

4. As for the Effects Analysis on IFRS 16 *Leases* published in January 2016, the Board plans to publish the Effects Analysis on IFRS 17 as a separate document, rather than as part of the Basis for Conclusions.

5. The Effects Analysis on IFRS 17 has been prepared using information about the likely effects of any new requirements gathered throughout the course of a project, taking into consideration the recommendations (summarised in the Appendix) made by the Effects Analysis Consultative Group in its November 2014 report. The Board has provided information about some of the likely effects of the new insurance contracts Standard at various stages of the project—for example, the Appendix B to the Basis of Conclusions on the 2013 Exposure Draft *Insurance Contracts* included the Board's assessment of the likely effects of the Standard proposed at that time.

6. The Board is currently working on a draft of the Effects Analysis on IFRS 17. The Effects Analysis on IFRS 17 will be approved by the Board as part of the balloting process for the new Standard.

Contents of the Effects Analysis on IFRS 17

7. The draft Effects Analysis on IFRS 17 is about 130 pages long and consists of:

   (a) an executive summary including:

      (i) a brief description of the key issues in existing insurance contracts accounting and the reasons for which IFRS 17 has been developed;

      (ii) an overview of the key requirements of IFRS 17 and of the improvements that those requirements are expected to introduce in terms of comparability and quality of financial information for entities issuing insurance contracts; and

      (iii) the Board's expectation that, because of the wide range of different accounting practices permitted by IFRS 4 and the wide variety of insurance contracts issued today, the changes in an entity's financial statements introduced by IFRS 17 and the costs to implement the new Standard will vary by entity and by jurisdiction.

   (b) seven detailed sections describing the likely effects of IFRS 17. The content of those sections is further described in paragraphs 9-28 of this paper.

   (c) three appendices including:

      (i) an overview of most common insurance products available in the market today.

      (ii) illustrations of the estimated effects of IFRS 17 on the balance sheet and on the statement of comprehensive income of insurers. The illustrations compare the information that results when entities apply IFRS 4 for accounting for insurance contracts with the information that is expected to result when entities apply IFRS 17. There is also an illustration of some of the disclosure requirements in IFRS 17.

(iii) the sources used to gather information about the number and the size of listed entities applying IFRS Standards that are expected to be affected by IFRS 17.

(d) a glossary with the definitions of terms used. This is because many terms used in the draft Effects Analysis are specific to insurance.

Section 1—Introduction

8. Section 1 of the draft Effects Analysis describes:

(a) the extensive consultation process undertaken by the Board to gather information about the likely effects of the new requirements for accounting for insurance contracts; and

(b) the methodology used for assessing those effects.

Section 2—Insurance accounting requirements in IFRS 17

9. Section 2 of the draft Effects Analysis discusses the key requirements for accounting for insurance contracts in IFRS 17, including:

(a) the definition of insurance contracts, reinsurance contracts and investment contracts with a discretionary participation feature;

(b) the separation of non-insurance components;

(c) the recognition and measurement of insurance contracts issued and reinsurance contracts held, highlighting peculiarities for contracts with a variable fee;

(d) the reporting performance of insurance contracts; and

(e) disclosures.

10. This section notes that there is greater divergence between the accounting models applied for long-term insurance contracts than there is between those applied for short-term insurance contracts. It therefore presents a summary of the key differences between the

wide range of insurance accounting practices permitted by IFRS 4 for long-term insurance contracts and the main requirements of IFRS 17.

Section 3—Entities affected

11. Section 3 of the draft Effects Analysis includes information about the entities that are likely to be most affected by the new requirements. This section focuses on the insurance industry. This is because, although IFRS 17 will apply to all entities that issue insurance contracts and not only to insurance entities, insurance contracts are generally issued by insurance entities.

12. This section provides information about the number and the size of listed insurance entities applying IFRS Standards, by geographical region and by primary business, as well as an overview of the use by jurisdictions of IFRS Standards for unlisted insurance entities.

13. This section also discusses the less significant effects of IFRS 17 on banks and investment entities, and on non-financial entities.

Section 4—Benefits

14. Section 4 of the draft Effects Analysis discusses the benefits introduced by IFRS 17 in terms of improved comparability and quality of financial information for entities issuing insurance contracts.

15. Sub-section 4.1 includes some real-life examples of the lack of comparability that exists today and discusses how IFRS 17 will improve comparability between:

    (a) entities issuing the same type of insurance contracts;

    (b) similar insurance contracts issued by the same group in different jurisdictions; and

    (c) entities operating in the insurance industry and entities operating in other industries.

16. Sub-section 4.2 discusses how IFRS 17 will improve the understanding of insurance entities' financial position and performance, enabling investors and analysts to make better economic decisions flowing from transparency about the risks from, and variability in,

obligations arising from insurance contracts, as well as from enhanced information about current and future profitability arising from insurance contracts.

Section 5—Costs

17. Section 5 of the draft Effects Analysis discusses the likely costs of applying the new requirements, including costs on initial application as well as ongoing costs.

18. This section also discusses the simplifications adopted by the Board to reduce costs of applying IFRS 17 (for example, the simplified measurement requirements for insurance contracts with a coverage period of 12 months or less and the exemption from applying IFRS 17 to some common contracts issued by non-insurance companies, such as most product warranties).

Section 6—Effects on an entity's financial statements

19. Section 6 of the draft Effects Analysis discusses the likely effects on an entity's financial statements (balance sheet, statement of comprehensive income and notes to the financial statements) and on key financial metrics used by insurance entities.

20. Sub-section 6.1 discusses the effects on an entity's balance sheet of IFRS 17 requirements for the measurement and presentation of insurance contracts, including the effects on reported equity when first applying IFRS 17. Given that the existing insurance accounting practices typically differentiate between short-term and long-term insurance contracts, this sub-section considers the effects of IFRS 17 on the measurement of insurance contracts for each of those types of contracts. It also analyses the directional effect of IFRS 17 on assets, liabilities and equity of entities issuing insurance contracts on the basis of some of the most common existing insurance accounting practices. For example, if, in applying IFRS 4, an insurance contract liability is measured using historical discount rates that are higher than the current rates, then when applying IFRS 17 the measurement of the insurance contract liability is expected to increase (and equity is expected to decrease). The opposite is true if, in applying IFRS 4, an insurance contract liability is measured using historical discount rates that are lower than the current rates.

21. Sub-section 6.2 discusses the effects that IFRS 17 will have on an entity's statement of comprehensive income. In particular this sub-section discusses the presentation of premiums and of finance expense related to insurance contracts, the recognition of the contract profit (contractual service margin) and of the risk adjustment, and the total amounts recognised in profit or loss. It also includes an illustration about improvements introduced by IFRS 17 on the presentation of insurance contracts within the statement of comprehensive income compared to a common method of presentation when applying IFRS 4.

22. Sub-section 6.3 discusses the effect that the disclosure requirements of IFRS 17 will have on an entity's notes to the financial statements, focusing on the disclosures on amounts reported in the financial statements, significant judgements made when applying IFRS 17 and risks arising from insurance contracts.

23. Sub-section 6.4 discusses the effect of IFRS 17 on the wide variety of financial metrics reported by insurance contracts, including non-GAAP measures.

Section 7—Other effects

24. Section 7 of the draft Effects Analysis considers other possible effects of the new Standard on specific aspects of the insurance business.

25. Sub-section 7.1 discusses the interaction between the requirements in IFRS 17 and the requirements in IFRS 9 *Financial Instruments*. This is because investing activities are important for insurance entities that are required to account for insurance contracts issued applying IFRS 4 or IFRS 17 and financial assets held applying IAS 39 or IFRS 9.

26. Sub-section 7.2 discusses the interaction with regulatory frameworks for insurance entities. This is because in some jurisdictions amounts reported by insurance entities applying IFRS Standards may provide some of the information needed for regulatory purposes and changes introduced by IFRS 17 may therefore affect those amounts used for regulatory purposes. In contrast, most jurisdictions have developed their regulatory requirements independently from accounting requirements. Accordingly, IFRS 17 is not expected to

directly affect regulatory reporting of insurance entities applying IFRS Standards in those jurisdictions. Although regulatory requirements and IFRS 17 have different objectives, the Board noted that there are some similarities regarding the measurement of insurance contracts that may reduce costs of implementation of IFRS 17. A summary of the similarities and differences between IFRS 17 requirements and Solvency II requirements for the measurement of insurance contracts is included in the draft Effect Analysis.

27. Sub-section 7.3 considers whether IFRS 17 might give rise to changes to the design and price of insurance products that would affect the insurance products available to policyholders.

Appendix

A1. The following table summarises how the draft Effects Analysis implements the recommendations made by the Effects Analysis Consultative Group in its November 2014 report.

Recommendations of the Effects Analysis Consultative Group	Draft Effects Analysis
The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity. The focus of the Board's assessment should be on how a proposed financial reporting change is likely to affect that objective. The Board is not required to assess possible broader economic consequences because these are beyond its objective. Changes to IFRS Standards are expected to lead to better decisions by investors relying on these reports. Changes to reporting requirements can also cause preparers to bear costs in complying with IFRS Standards and users of the financial reports to bear costs to absorb and process the new information. The Board should assess and explain how general purpose financial reports are likely to change because of the new requirements, and why those changes will improve the quality of general purpose financial reports. The Board should also explain why it considers those changes to be justifiable, by demonstrating how it assessed the likely effects on the direct costs to preparers of meeting the new requirements and the related costs to users.	The draft Effects Analysis makes clear that the focus of the Board's assessment is on how the financial reporting changes set out in IFRS 17 are likely to affect the objective referred to by the Board. As noted within paragraph 4 of this document, the draft Effects Analysis considers the following aspects: (a) how comparability of financial information will be affected both between different reporting periods for the same entity and between different entities in a particular reporting period; (b) how the ability of users of financial statements to assess the amount, timing and uncertainty of an entity's future cash flows, as well as the entity's financial position and performance, will be affected; (c) whether better economic decision-making will be possible as a result of improved financial reporting; (d) how compliance costs for preparers will be affected, both on initial application and on an ongoing basis; and (e) how costs of analysis for users of financial statements will be affected.

<table>
<tr><th>Recommendations of the Effects Analysis Consultative Group</th><th>Draft Effects Analysis</th></tr>
<tr><td>The mandate of the Financial Stability Board (FSB) is to promote the stability of financial markets as a whole. The Board's focus is on ensuring that investors have high quality, transparent and comparable information general purpose financial reports about individual entities.

To help the FSB achieve its objectives, the Board should, without compromising its own objectives, continue to engage with the FSB to ensure that the FSB is aware of proposed changes to financial reporting and has sufficient time to assess and address how changed financial reporting information should be incorporated into their monitoring systems.</td><td>The draft Effects Analysis makes clear that IFRS 17 will:
(a) improve the comparability of insurance entities' financial statements, by removing the diversity that exists today in insurance contracts accounting.
(b) improve the understanding of insurance entities' financial position, by requiring a current measurement of insurance contracts. This will ensure that major changes in the economic environment, such as deep and sustained declines in interest rates, are reflected in the financial statements of entities issuing insurance contracts on a timely basis.
(c) enable investors and analysts to make better economic decisions flowing from transparency about the risks from, and variability in, obligations arising from insurance contracts.

It will also make clear (albeit without referring specifically to the FSB) that the Board maintains an ongoing dialogue with regulators and other interested parties to raise awareness of the likely effects of IFRS 17.</td></tr>
</table>

Recommendations of the Effects Analysis Consultative Group	Draft Effects Analysis
The objective of general purpose financial reports prepared using IFRS Standards is to provide financial information relevant to those making decisions about providing resources to the entity. The Board recognises that other parties use general purpose financial statements for their own objectives—including determining taxable income, determining distributable reserves, statistical purposes and regulation. It is not the responsibility of the Board to tailor financial reporting to meet the needs of these other parties. The Board recognises, however, that it has an obligation to allow these other parties to observe changes to financial reporting that could have implications for their activities. It is important that the Board maintains strong and open communication links with other accounting standard‑setters for this purpose.	The draft Effects Analysis provides a very high level summary of the extensive consultation that has taken place on the project, including three public consultations on the Board's insurance contracts proposals and the holding of hundreds of meetings, round tables and other outreach activities. This included extensive discussions with preparers and users of financial statements, actuaries, regulators, standard-setters and accounting firms worldwide. The draft Effects Analysis summarises the Board's assessment of the likely effects of IFRS 17 on an entity's financial statements, including effects on key financial metrics.
Other accounting standard-setters may have responsibilities within their local jurisdiction regarding assessment of effects of a change in accounting standards. It is not the responsibility of the Board to meet those requirements. However, the Board should work co-operatively with local standard-setters so, where possible, it can plan its fieldwork and outreach in ways that are mutually beneficial for the Board and those local jurisdictions.	As mentioned above, the consultation process to develop IFRS 17 included extensive discussions with other accounting standard-setters.

<table>
<tr><th>Recommendations of the Effects Analysis Consultative Group</th><th>Draft Effects Analysis</th></tr>
<tr><td>The Board should plan its fieldwork so that it is proportionate to the changes in financial reporting being proposed. Pervasive and significant changes generally warrant a more comprehensive assessment programme than is needed for narrow-scope changes.

The type, and depth, of fieldwork undertaken should also reflect the stage of development of the project.

At the finalisation of a Standard, the Board is explaining the basis for its decisions and what it expects to be the effects of the changes to financial reporting requirements. Accordingly, the fieldwork and analysis should explain how the Board has made its final decisions.</td><td>The draft Effects Analysis sets out the changes to accounting requirements introduced by IFRS 17 and the likely effects on:
(a) entities applying IFRS Standards.
(b) comparability and quality of financial information for insurance contracts.
(c) both implementation costs and ongoing costs.
(d) the financial statements of entities issuing insurance contracts. In addition, Appendix B to the draft Effects Analysis includes illustrations showing the effects of IFRS 17 on an entity’s balance sheet, statement of comprehensive income and notes to the financial statements.
(e) specific aspects of the insurance business, including the interaction between regulatory and accounting requirements.</td></tr>
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Recommendations of the Effects Analysis Consultative Group	Draft Effects Analysis
The Board has a responsibility to give full and fair consideration to the perspectives of those affected by IFRS Standards globally. The Board should aim to undertake consultation that is geographically broad-based so that its Standards are written with principles that can be applied globally. Other accounting standard‑setters can help by providing the Board with analysis and information about effects in their jurisdiction generally as well as about factors that might be unique to their jurisdiction. However, the Board must make its assessment from a global perspective and not make its decisions because of how the new requirements could affect a particular jurisdiction. There might be circumstances in which the net benefits of a new requirement are negligible (or event create a net burden) for entities within a particular jurisdiction. The Board's assessment needs to be whether new financial reporting requirements are justifiable on a global basis.	The assessment in the draft Effects Analysis is made from a global perspective. As insurance accounting practices vary by jurisdictions in applying IFRS 4, the draft Effects Analysis: (a) includes an analysis of the key differences between the wide range of insurance accounting practices permitted by IFRS 4 and the main requirements of IFRS 17; and (b) explains that effects are expected to vary for different entities in different jurisdictions, depending on the entities' previous insurance accounting practices.
The Board should consider ways to increase the involvement of other accounting standard-setters in undertaking fieldwork locally and sharing the results with the Board.	The draft Effects Analysis includes a very high-level summary of the consultation process, referring to the extensive discussions with other accounting standard-setters (and other constituents). The insurance contracts project page on the website provides details of the consultation undertaken with various groups and categories of stakeholder, and outreach in general.

Recommendations of the Effects Analysis Consultative Group	Draft Effects Analysis
The Board should make available information about the nature of fieldwork and outreach it has undertaken. The Board should take steps to ensure that fieldwork tools such as surveys and case studies are easily accessible on the project website. Such information should also include identifying as clearly and openly as possible, while respecting requests for confidentiality, who has participated in the fieldwork and the evidence that has been collected. This information should be made available throughout the development of the project. When it is not possible for the Board to disclose the identities of individual participants in fieldwork, the Board should provide as much information as it is able to for outside parties to be able to understand the profile of fieldwork participants.	Information about outreach and fieldwork undertaken on the insurance contracts project (including information about the participants) is available on the relevant project page on the website.[3]
The format of the analysis of the likely effects of a proposed change in financial reporting should reflect the stage of the proposals. When a new Standard is issued, the Board should generally prepare a separate Effects Analysis Report. A tightly-focused document that summarises the likely effects and how the Board made the assessments can help those with a particular interest in this work. Any such report should be included with the package of documents balloted by the Board.	The Board plans to publish the Effects Analysis on IFRS 17 as a separate document (rather than as part of the Basis for Conclusions). The Board will approve the Effects Analysis as part of the balloting process for the new Standard.

[3] http://www.ifrs.org/Current-Projects/IASB-Projects/Insurance-Contracts/Pages/Round-IV-topic-based-field-work.aspx and http://www.ifrs.org/Current-Projects/IASB-Projects/Insurance-Contracts/Exposure-Draft-June-2013/Pages/Outreach-activities.aspx