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STAFF PAPER

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Project	Amendments to IFRS 17		
Paper topic	Reinsurance contracts held—recovery of losses		
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Purpose of the paper

1. This paper discusses staff analysis and recommendations about the amendment proposed in the Exposure Draft *Amendments to IFRS 17* relating to reinsurance contracts held. This paper follows the tentative decision of the International Accounting Standards Board (Board), at its November 2019 meeting, to consider further the feedback from outreach and comment letters on this proposed amendment.

Summary of staff recommendations

2. The staff recommend the Board:
   (a) extend the scope of the proposed amendment to IFRS 17 *Insurance Contracts* to require an entity to adjust the contractual service margin of a group of reinsurance contracts held, and as a result recognise income, when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to that group.
   (b) amend the proposed calculation of the income, as a consequence of the extension of the scope of the proposed amendment, to require an entity to determine the amount of a loss recovered from a reinsurance contract held by multiplying:

(i) the loss recognised on the group of underlying insurance contracts; and

(ii) the percentage of claims on underlying insurance contracts the entity expects to recover from the reinsurance contract held.

(c) not add the proposed footnote to paragraph BC304 of the Basis for Conclusions on IFRS 17.

(d) confirm that the amendment to IFRS 17 described in paragraph 2(a) of this paper would apply only when the reinsurance contract held is recognised before or at the same time as the loss is recognised on the underlying insurance contracts.

(e) clarify, in the final amendments to IFRS 17, that paragraph 66(c)(ii) of IFRS 17—for subsequent measurement of a group of reinsurance contracts held when a group of underlying insurance contracts become onerous—applies when underlying insurance contracts are measured applying the premium allocation approach.

Structure of the paper

3. This paper provides:

(a) an overview of the proposals in the Exposure Draft;

(b) an overview of the feedback; and

(c) the staff analysis, recommendations and questions for Board members.

4. Appendix A to this paper provides three examples of applying the proposed amendment in the Exposure Draft.

Proposals in the Exposure Draft

5. The Exposure Draft proposed an amendment to the measurement of a group of reinsurance contracts held.[1] The proposed amendment would require an entity to adjust the contractual service margin of a group of reinsurance contracts held that provide proportionate coverage, and as a result recognise income, when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to that group.

6. The amount of the adjustment and resulting income would be determined by multiplying:

   (a) the loss recognised on the group of underlying insurance contracts; and

   (b) the fixed percentage of claims on the group of underlying insurance contracts the entity has a right to recover from the group of reinsurance contracts held.

7. The Exposure Draft proposed the amendment would apply only when:

   (a) a reinsurance contract held provides proportionate coverage. That is, as noted in the calculation in paragraph 6 of this paper, when the entity has the right to recover from the reinsurer a percentage of all claims incurred on groups of underlying insurance contracts. The percentage the entity has a right to recover is fixed for all contracts in a single group of underlying insurance contracts but can vary between groups of underlying insurance contracts.

   (b) the reinsurance contract held is recognised before or at the same time as the loss is recognised on the underlying insurance contracts.

8. Applying the proposed amendment, an entity would:

   (a) recognise income in the statement of financial performance (credit); and

   (b) increase the reinsurance contract held asset on the statement of financial position (debit) by increasing the net cost that will be recognised over the coverage period or decreasing the net gain that will be recognised over the

[1] See paragraphs 66A–66B and B119C–B119F of the Exposure Draft and paragraphs BC67–BC90 of the Basis for Conclusions on the Exposure Draft.

coverage period, depending on whether the reinsurance contract held is in a net cost or net gain position.

9. The Exposure Draft proposed adding a footnote to paragraph BC304 of the Basis for Conclusions on IFRS 17 to explain that if a reinsurance contract held covers claims in excess of a specified amount on an individual insurance contract that reinsurance contract does not provide proportionate coverage.[2]

Feedback

10. Most respondents expressed support for the objective of the proposed amendment. However, they expressed the view that the proposed amendment requires refinement to achieve the Board's objective of making it easier for entities to explain their results to investors. Respondents expressed concerns about:

    (a) the proposed population of reinsurance contracts held to which the amendment would apply (see paragraphs 12–20 of this paper); and

    (b) the proposed calculation of income on the reinsurance contract held (see paragraphs 21–23 of this paper).

11. Respondents also commented on other aspects of the proposed amendment (see paragraphs 24–27 of this paper).

Proposed population

12. Most respondents, particularly preparers, expressed concerns that the proposed amendment would apply only to a limited population of reinsurance contracts held. Those respondents expressed the view that either:

    (a) the definition of a reinsurance contract held that provides proportionate coverage should be extended; or

    (b) the proposed amendment should apply to all reinsurance contracts held.

[2] Paragraph BC304 of the Basis for Conclusions on IFRS 17 explains that, in some cases, a reinsurance contract held covers the losses of separate contracts on a proportionate basis.

Definition of proportionate coverage

13. Some respondents did not disagree with the proposed amendment applying only to reinsurance contracts held that provide proportionate coverage. However, many of those respondents expressed the view that the definition of proportionate coverage proposed in the Exposure Draft is too narrow. Those respondents noted only a few reinsurance contracts held would meet that proposed definition and, therefore, expressed the view that the proposed amendment would not address the concerns previously raised by stakeholders.

14. Examples of reinsurance contracts held that respondents explained are commonly described in practice as proportional but would not meet the definition of proportionate coverage proposed in the Exposure Draft include:

    (a) reinsurance contracts held that provide an entity with the right to recover from the reinsurer a fixed percentage of claims, but with either a *minimum retention,* a *maximum limit* or both. For example, a right to recover 40% of any claims above CU20.[3] The existence of a minimum retention, a maximum limit or both would preclude the reinsurance contract held from meeting the proposed definition.

    (b) reinsurance contracts held that provide an entity with the right to recover from the reinsurer claims above a minimum retention on an *individual* underlying insurance contract. For example, a right to recover any claims above CU10 on each underlying insurance contract. The existence of a minimum retention would preclude the reinsurance contract held from meeting the proposed definition.

    (c) reinsurance contracts held that provide an entity with the right to recover from the reinsurer a fixed percentage of some, but not all, types of claims covered by the underlying insurance contracts. For example, an entity sells insurance contracts providing coverage in the event of accidental fire, flood or earthquake. The reinsurance contract held provides the entity with a right to recover a fixed percentage of any claims arising from an earthquake event only. The reinsurance contract held does not provide coverage for a fixed

[3] In this paper amounts are denominated in 'currency units' (CU).

percentage of all claims on the underlying insurance contract and therefore would not meet the proposed definition.

(d) reinsurance contracts held that provide an entity with the right to recover from the reinsurer a fixed percentage of all claims on each individual underlying insurance contract, but the percentage is different for each underlying contract and the entity includes the underlying contracts in the same group. The percentage the entity has a right to recover is not fixed for all contracts in a single group of underlying contracts and, therefore, the reinsurance contract held would not meet the proposed definition.

15. Some respondents suggested the Board amend the proposed definition of a reinsurance contract held that provides proportionate coverage to include the contracts described in paragraph 14 of this paper. To achieve this, some respondents suggested the definition should be a reinsurance contract held that provides an entity with the right to recover from the issuer a *contractually defined portion of each claim* incurred on individual underlying insurance contracts.

All reinsurance contracts held

16. Consistent with feedback during the development of the Exposure Draft, some respondents continued to express the view that the proposed amendment should apply to *all* reinsurance contracts held. For example, in addition to the reinsurance contracts discussed in paragraph 14 of this paper, those respondents think the amendment should apply to reinsurance contracts held that provide an entity with the right to recover from the reinsurer the aggregate amount of claims from a number of underlying insurance contracts in excess of an aggregate retention amount. For example, a right to recover all claims above a CU200 aggregate retention on all underlying insurance contracts issued in a specified period.

17. In those respondents' view, the same accounting mismatch between a reinsurance contract held and onerous underlying insurance contracts would arise regardless of whether the reinsurance contract held provides proportionate coverage or coverage that is not proportionate. Those respondents expressed the view that the proposed amendment would result in an inconsistent accounting treatment of reinsurance contracts that are entered into to achieve the same economic outcome.

18. Those respondents noted that IFRS 17 already includes an exception which addresses a similar accounting mismatch between a reinsurance contract held and onerous underlying insurance contracts on *subsequent measurement*. That exception applies to all reinsurance contracts held. In their view, extending the proposed amendment to apply also to all reinsurance contracts held would improve consistency within the Standard by making the accounting at initial recognition consistent with the subsequent accounting.

19. Those respondents acknowledged the Board's rationale for limiting the proposed amendment to reinsurance contracts held that provide proportionate coverage. The Board was concerned that the timing mismatch between the recognition of claims on underlying insurance contracts and the recognition of claim recoveries on the reinsurance contract held could not be directly identified for reinsurance contracts held that do not provide proportionate coverage. However, those respondents suggested an alternative amendment that they think would:

    (a) resolve the accounting mismatch for all types of reinsurance contracts held.

    (b) address the Board's concerns. In the view of those respondents, the suggested amendment would result in the income on the reinsurance contract held being identified in a direct and consistent way, without arbitrary assumptions or subjective judgements.

20. Those respondents suggested the proposed amendment should apply to all reinsurance contracts held by requiring an entity to:

    (a) identify the percentage of *all* underlying claims the entity *expects* to recover through the reinsurance contract held; and

    (b) recognise income (loss recovery) on the reinsurance contract held by multiplying the loss on the underlying insurance contracts by that percentage.

Proposed calculation

21. Most respondents that commented on the proposed amendment did not comment on the proposed calculation of income on the reinsurance contract held (loss-recovery calculation). Of those respondents who commented on the proposed loss-recovery

calculation, a small number of respondents expressed support for the calculation and noted that it would be a practical solution.

22. As discussed in paragraph 20 of this paper, some respondents suggested the Board amend the loss-recovery calculation to reflect the extension of the scope of the proposed amendment to all reinsurance contracts held suggested by those respondents.

23. Some respondents expressed concerns about the proposed calculation. Particularly:

(a) some respondents, including some reinsurance brokers and some insurance industry representative bodies, expressed concerns that the calculation of the loss recovery is determined considering only the connection between claims on the underlying insurance contracts and claims recoveries on the reinsurance contract held. In those respondents' view, although practical to apply, such an approach might not be appropriate. For example, those respondents said that a loss on underlying insurance contracts might result from acquisition costs, rather than claims, and acquisition costs are typically not recoverable from the reinsurer. In their view, an entity should be required to apply judgement to identify the extent to which the net fulfilment cash flows of the reinsurance contract held result from the onerous underlying insurance contracts. Such an approach would require an entity to identify the connections, if any, between:

(i) all fulfilment cash flows that contribute to the *loss on the underlying insurance contracts* (for example, premiums, claims, acquisition costs, other expenses and the risk adjustment for non-financial risk); and

(ii) all fulfilment cash flows that contribute to the *net cost or net gain on the reinsurance contract held* (for example, reinsurance premiums, claims recoveries, reinsurance commissions and the risk adjustment for non-financial risk).

(b) some respondents, including a regulator and a national standard-setter, expressed concerns that the proposed amendment could result in an entity recognising income on a reinsurance contract held that is in a net cost position. In those respondents' view, the proposed amendment would not reflect the economics of a reinsurance contract that is in a net cost position and would be open to abuse to achieve an accounting outcome. Those respondents expressed concerns that applying the proposed amendment when a reinsurance contract held is in a net cost position would result in the entity deferring losses because the entity would recognise income and, at the same time, increase the net cost it will recognise on the reinsurance contract held over time. In addition, those respondents were concerned that losses would not be visible to users of financial statements. Those respondents suggested the loss recovery should be limited to the amount of any net gain on the reinsurance contract held.

Other feedback

Proposed footnote in the Basis for Conclusions on IFRS 17

24. Some respondents think the proposed footnote to paragraph BC304 of the Basis for Conclusions on IFRS 17 discussed in paragraph 9 of this paper narrows the Board's previous explanation of proportionate reinsurance contracts in that paragraph. Those respondents suggested the Board does not add the proposed footnote because they think doing so would disrupt implementation of the requirements in paragraph 62 of IFRS 17 for the recognition of reinsurance contracts held, which distinguishes between reinsurance contracts held that provide proportionate coverage and other reinsurance contracts held.

Timing of entering into the reinsurance contract held

25. A small number of respondents commented on the proposal that, for the proposed amendment to apply, the reinsurance contract held would need to be recognised before or at the same time as the loss is recognised on the underlying insurance contracts (see paragraph 7(b) of this paper). Some of those respondents expressed concerns and suggested the Board consider permitting application of the proposed amendment also when the reinsurance contract held is recognised *after* the loss is recognised on the underlying insurance contracts. In contrast, other respondents agreed with the Board's rationale for requiring the reinsurance contract held to be recognised before or at the same time as the loss is recognised.

Guidance on the loss-recovery component

26. A small number of respondents asked for clarification or guidance on the accounting treatment for the loss-recovery component of a group of reinsurance contracts held. One respondent suggested that guidance could be provided by extending the illustrative example accompanying the Exposure Draft.

Premium allocation approach

27. A small number of respondents expressed support for the proposed amendment applying when either the reinsurance contract held or underlying insurance contracts are accounted for applying the premium allocation approach. Some of those respondents asked the Board to clarify that the existing exception in paragraph 66(c)(ii) of IFRS 17 for *subsequent measurement* of a reinsurance contract held when a group of underlying insurance contracts becomes onerous applies when underlying insurance contracts are accounted for applying the premium allocation approach. Those respondents noted that paragraph refers to the contractual service margin of the underlying insurance contracts and that the measurement of insurance contracts applying the premium allocation approach does not include a contractual service margin.

Staff analysis and recommendations

28. The staff analysis in this paper is structured as follows:

    (a) proposed population (paragraphs 29–42 of this paper);

    (b) proposed calculation (paragraphs 43–58 of this paper); and

    (c) other feedback (paragraphs 59–64 of this paper).

Proposed population

29. The Board limited the scope of the proposed amendment to contracts that meet both the following criteria:

    (a) reinsurance contracts held for which an entity could identify a known reinsurance claim recovery for each CU1 of underlying insurance claim. For example, if an entity has the right to recover 40% of all claims from the reinsurer, the entity can identify a known recovery of CU0.4 for each CU1 of claim. With the scope of the proposed amendment limited in this way, the Board concluded that an entity could identify the loss recovery on the reinsurance contract held by assuming that the loss on the underlying insurance contracts results solely from claims. In the example, if the loss was CU20, the loss recovery would be CU8.

(b) reinsurance contracts held that provide the entity with the right to recover a fixed percentage of *all* claims incurred on a group of underlying insurance contracts and for which the percentage the entity has a right to recover is fixed for *all* contracts in that group. The Board proposed limiting the scope of the amendment in this way to minimise the operational complexity that would result from applying the proposed amendment.

30. Accordingly, a reinsurance contract held is excluded from the scope of the proposed amendment if one or both of the following apply:

(a) the reinsurance contract held includes a feature such as a minimum retention or maximum limit. Such features mean that it is not possible to identify a known reinsurance claim recovery for each CU1 of underlying insurance claim. The Board decided not to include such contracts in the scope of the proposed amendment because the Board was concerned that for those contracts an entity would be required to use estimates to identify the loss recovery which may require a more complex loss-recovery calculation compared to the simple calculation proposed by the Board.

(b) the reinsurance contract held does not cover, at the same fixed percentage, *all* claims incurred on a *group* of underlying insurance contracts.

31. Although the scope of the proposed amendment was limited, the amendment would address stakeholder concerns about the examples of reinsurance contracts held that stakeholders previously provided to the Board to demonstrate an accounting mismatch on initial recognition of onerous underlying insurance contracts.[4] The proposed

[4] Those examples were included in Agenda Paper 2C *Appendix to reinsurance contracts held—onerous underlying insurance contracts* of the January 2019 Board meeting.

amendment would also apply to a wider population of reinsurance contracts held than the examples of reinsurance contracts held provided to the Board. This is because the examples provided to the Board included both premiums and claims that are proportionate, whereas the proposed amendment would require only that claims be proportionate. For reinsurance contracts held to which the proposed amendment would apply, the proposed amendment would address stakeholder concerns in a manner that could be consistently and robustly applied without significant operational implications.

32. However, the feedback from outreach and comment letters provides additional information about common features of reinsurance contracts in practice that would mean that many reinsurance contracts held would not be within the scope of the proposed amendment. In the light of the feedback that the proposed amendment would apply only to a few reinsurance contracts held, the staff analysis considers whether the Board should extend the scope of the proposed amendment.

Definition of proportionate coverage

33. Some respondents suggested the Board extend the definition of proportionate coverage proposed in the Exposure Draft to include reinsurance contracts held that are commonly described in practice as proportional, as discussed in paragraph 14 of this paper. The staff expect that, if the Board were to extend the definition in that way, the amendment might apply to a much larger population of reinsurance contracts held than proposed in the Exposure Draft.

34. However, the reasons for which the Board decided to exclude many reinsurance contracts held from the scope of the proposed amendment (as discussed in paragraph 30 of this paper) apply as much to reinsurance contracts held that are commonly described in practice as proportional (as discussed in paragraph 14 of this paper) as to other reinsurance contracts held. The staff have not identified a reason to consider amending the definition of a reinsurance contract held that provides proportionate coverage. Therefore, the staff analysis in paragraphs 35–42 of this paper considers whether the Board should extend the scope of the proposed amendment to apply to all reinsurance contracts held.

All reinsurance contracts held

35. As noted in paragraphs 29–31 of this paper, the Board limited the scope of the proposed amendment to apply only when a loss on an underlying insurance contract has a *known* recovery from the reinsurance contract held. The Board concluded that the limitation was appropriate, considering that the proposed amendment would be an exception to the principles of the Standard and would result in the recognition of income immediately in profit or loss before any service is received. In addition, the proposed limited scope meant that the loss recovery could be calculated applying a simplified approach.

36. The staff note that the respondents who suggested the proposed amendment apply to all reinsurance contracts held suggested the calculation should be applied based on the *total expected* recovery from the reinsurance contract held. Those respondents expressed the view that such an approach would be consistent with the measurement requirements in IFRS 17 which are based on expected cash flows.

37. In those respondents' view, such an approach would address the Board's concerns that, for reinsurance contracts held that do not provide proportionate coverage, the timing mismatch between the recognition of claims on underlying insurance contracts and the recognition of claim recoveries on the reinsurance contract held could not be directly identified. Those respondents think that the mismatch can be identified based on estimates that are required by IFRS 17.

38. Consider an example of a reinsurance contract held that provides the entity with the right to recover from the reinsurer 40% of the aggregate of claims above CU200 on a number of underlying insurance contracts. Assume the entity expects total claims of CU1,200 on the underlying insurance contracts and accordingly expects total reinsurance claim recoveries of CU400. The percentage of all underlying claims the entity expects to recover from the reinsurance contract held is 33%. Those respondents suggested that if a loss of CU15 is recognised on an individual underlying insurance contract, an entity should recognise a loss recovery of CU5 (CU15 x 33%).

39. The staff are persuaded by the view that a loss-recovery calculation based on total expected reinsurance recoveries would be consistent with the general measurement requirements of IFRS 17 that are comprehensively based on expectations about future

cash flows.[5] In addition, the staff agree with some respondents that requiring the proposed amendment to apply to all reinsurance contracts held would increase comparability between reinsurance contracts held that are entered into to achieve the same outcome.

40. The suggestion from respondents in paragraph 36 of this paper would maintain some of the simplicity of the amendment proposed in the Exposure Draft because it builds on the proposed loss-recovery calculation whereby an entity would assume the loss on underlying insurance contracts is caused by claims and multiple the loss by a loss-recovery percentage to determine the loss recovery.

41. The consequence of the suggestion is that the proposed loss-recovery calculation may not be as simple to apply for reinsurance contracts held that are outside the scope of the proposed amendment in the Exposure Draft. This was one of the reasons the Board limited the scope of the proposed amendment in the Exposure Draft. In some circumstances, to determine the total percentage of claims an entity expects to recover from the reinsurance contract held, the entity would be required to identify all expected claims across more than one group of underlying insurance contracts, including expected claims on insurance contracts expected to be issued in the future. However, the staff note that IFRS 17 already requires an entity to have that information for the purpose of determining the cash flows in the measurement of the reinsurance contract held. In addition, some respondents expressed the view that applying the proposed loss-recovery calculation based on the total percentage of claims an entity expects to recover from a reinsurance contract held would not add significant operational complexity.

42. In the light of the feedback from outreach and comment letters, the staff view is that, on balance, the benefit of extending the proposed amendment to apply to all reinsurance contracts held would outweigh the cost. Therefore, the staff recommend the Board extend the scope of the proposed amendment to IFRS 17 to require an entity to adjust the contractual service margin of a group of reinsurance contracts held, and as a result recognise income, when the entity recognises a loss on initial

[5] For example, IFRS 17 requires the measurement of insurance contracts to include expected cash outflows over which the entity has discretion (see paragraph B65 of IFRS 17 and paragraphs BC169–BC170 of the Basis for Conclusions on IFRS 17).

recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to that group.

Question 1 for Board members
Do you agree the Board should extend the scope of the proposed amendment to IFRS 17 to require an entity to adjust the contractual service margin of a group of reinsurance contracts held, and as a result recognise income, when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to that group?

Proposed calculation

43. Some respondents expressed concerns about the proposed loss-recovery calculation. Specifically, as discussed in paragraph 23 of this paper, some respondents expressed concerns about:

(a) the assumption that a loss on underlying insurance contracts is caused by claims, without considering any other cash flows that contribute to the loss; and

(b) the calculation being based on the connection between insurance claims and reinsurance claim recoveries, without considering whether the reinsurance contract held is in an overall net gain or net cost position.

Assumption that a loss on underlying insurance contracts is caused by claims

44. In regard to the concern discussed in paragraph 43(a) of this paper, the staff note that the loss on underlying insurance contracts results from all fulfilment cash flows. This includes premiums, claims, insurance acquisition cash flows, other expenses allocated to the group of insurance contracts and the risk adjustment for non-financial risk. The staff think that any attempt to identify a loss as arising from specific cash flows would be arbitrary.

45. In developing the proposed amendment, the Board decided that it was necessary to make a simplified assumption about the cause of a loss when identifying how much of the loss is recovered through a reinsurance contract held. Without that assumption, an

entity would be required to identify the connection between all fulfilment cash flows in the measurement of the insurance contract issued and all fulfilment cashflows in the measurement of the reinsurance contract held. In the Board's view, doing so would often be complex and burdensome, and could itself require arbitrary assumptions—in particular, this would be difficult when a reinsurance contract held covers many underlying insurance contracts. In addition, because arbitrary assumptions would be required, the result would not be comparable between entities.

46. In the staff view, the Board's rationale for proposing a simplified approach continues to hold. An assumption that the loss on insurance contracts is caused solely by claims would be operationally simple and would reflect fully the connection between insurance claims and reinsurance claim recoveries.

Calculation based on the connection between insurance claims and reinsurance claim recoveries

47. In regard to the concern discussed in paragraph 43(b) of this paper, the staff note that those respondents were supportive of the result of applying the proposed amendment in scenarios in which the loss recovery is equal to the net gain on a reinsurance contract held. That would be the result of applying the proposed amendment in scenarios in which both premiums and claims are proportionate. However, those respondents disagreed with the result of applying the proposed amendment in scenarios in which the loss recovery is more than the net gain, or the reinsurance contract held is in a net cost position. That would be the result of applying the proposed amendment in scenarios in which premiums are not proportionate.

48. Example 1 in Appendix A to this paper demonstrates the result of applying the proposed amendment in the Exposure Draft when both premiums and claims are proportionate. The amounts recognised in profit or loss are included in the following tables.

IFRS 17 as originally issued	**Recognised immediately**	**Recognised over time**
Insurance contracts issued	(50)	-
Reinsurance contracts held	-	20
Profit/(loss)	**(50)**	**20**

Proposed amendment in the Exposure Draft	Recognised immediately	Recognised over time
Insurance contracts issued	(50)	-
Reinsurance contracts held	20	-
Profit/(loss)	**(30)**	**-**

49. The result of applying the proposed amendment in Example 1 reflects that, when both premiums and claims are proportionate, a reinsurance contract held acts similarly to a profit-sharing contract.

50. Example 2 and Example 3 in Appendix A to this paper demonstrate the results of applying the proposed amendment when premiums are not proportionate. In Example 3, the reinsurance contract held is in a net cost position and the amounts recognised in profit or loss are included in the following tables.

IFRS 17 as originally issued	Recognised immediately	Recognised over time
Insurance contracts issued	(50)	-
Reinsurance contracts held	-	(5)
Profit/(loss)	**(50)**	**(5)**

Proposed amendment in the Exposure Draft	Recognised immediately	Recognised over time
Insurance contracts issued	(50)	-
Reinsurance contracts held	20	(25)
Profit/(loss)	**(30)**	**(25)**

51. Some respondents expressed concerns that in Example 2 and Example 3, the result of applying the proposed amendment could be viewed as the deferral of a loss. In these examples, the premiums are not proportionate and, in contrast to Example 1, the reinsurance contract held does not act like a profit-sharing contract. In Example 3, the loss recovery of CU20 recognised immediately reflects the amount of the CU50 loss the entity expects to recover from the reinsurer. The net cost of CU25 recognised over time reflects the amount the reinsurer charges the entity for *all* reinsurance coverage the entity will receive. That reinsurance coverage includes:

    (a) the right to recover CU20 of the CU50 expected loss;

(b) the right to recover CU40 of CU100 expected claims in addition to the expected loss; and

(c) the right to recover amounts relating to any *unexpected* claims.

52. In addition, the cost could relate, in part, to recovery of expenses other than claims.

53. Some respondents expressed concerns that in Example 2 and Example 3 losses would not be visible to users of financial statements. However, the staff note that applying the reconciliation requirement in paragraph 100 of IFRS 17, an entity would disclose both the loss component on underlying insurance contracts and the loss-recovery component on a reinsurance contract held. Those disclosures would provide users of financial statements with information about the amount of losses on insurance contracts issued and the extent to which those losses are recoverable through reinsurance contracts held.

54. Some respondents expressed concerns that, in Example 2 and Example 3, the proposed amendment would be open to abuse. Consider the following example. An entity issues an insurance contract with premiums of CU280 and expected claims of CU300. The insurance contract is onerous and the entity recognises a loss of CU20. At the same time, the entity purchases a reinsurance contract held to recover 100% of underlying claims for a reinsurance premium of CU300. In that example, if claims occur as expected, the reinsurance contract held has no overall effect on the net cash flows of the entity. With or without the reinsurance contract held the entity has a net cash outflow of CU20. However, applying the proposed amendment, the entity would recognise a loss recovery of CU20 at the same time it recognised the loss of CU20 (net effect of zero in profit or loss on day one) and a net cost of CU20 would be recognised over time.

55. The staff note that in the example in paragraph 54 of this paper, the entity has a right to recover from the reinsurer both expected claims and any unexpected claims and that the entity will receive service from the reinsurer over time. The CU20 net cost that would be recognised over time would reflect the net cost of the service the entity is receiving from the reinsurer. In addition, the proposed amendment would apply only when the reinsurance contract held is recognised before or at the same time as the loss is recognised on the underlying insurance contract. In the staff view, that

requirement, in addition to the requirement to disclose the loss component and the loss-recovery component, should limit the possibility of abuse.

56. The staff understand why some respondents think that useful information would be provided by limiting the amendment to the amount of any net gain on a reinsurance contract held so that the amendment would apply only in scenarios such as Example 1. However, the staff note that such an approach would apply only when the reinsurance contract held covers only one underlying insurance contract. When a reinsurance contract held covers many underlying insurance contracts, it is often not possible to identify the extent to which the overall net gain or net cost relates to each individual underlying insurance contract. The staff think the Board should not require an entity to separate a reinsurance contract held in this way, for the reasons set out in paragraph 45 of this paper.

57. Considering the analysis in paragraphs 43–56 of this paper, the staff continue to hold the view that the proposed loss-recovery calculation (amended to reflect the recommended extension of the scope of the proposed amendment in paragraph 42 of this paper) would:

(a) address stakeholder concerns about an accounting mismatch on initial recognition of onerous underlying insurance contracts;

(b) be operationally simple for entities to apply; and

(c) provide comparable, transparent and useful information for users of financial statements.

58. Therefore, the staff recommend the Board amend the proposed calculation of income, as a consequence of the extension of the scope of the proposed amendment, to require an entity to determine the amount of a loss recovered from a reinsurance contract held by multiplying:

(a) the loss recognised on the group of underlying insurance contracts; and

(b) the percentage of claims on underlying insurance contracts the entity expects to recover from the reinsurance contract held.

Question 2 for Board members
Do you agree the Board should amend the proposed calculation of income, as a consequence of the extension of the scope of the proposed amendment, to require an entity to determine the amount of a loss recovered from a reinsurance contract held by multiplying: (a) the loss recognised on the group of underlying insurance contracts; and (b) the percentage of claims on underlying insurance contracts the entity expects to recover from the reinsurance contract held?

Other feedback

Proposed footnote in the Basis for Conclusions on IFRS 17

59. As discussed in paragraph 24 of this paper, some respondents think the proposed footnote to paragraph BC304 of the Basis for Conclusions on IFRS 17 narrows the Board's previous explanation of proportionate reinsurance in that paragraph. A distinction between reinsurance contracts held that provide proportionate coverage and other reinsurance contracts held already exists in IFRS 17 for the purpose of the requirements to recognise reinsurance contracts held in paragraph 62 of IFRS 17. As a simplification to the general recognition requirements in IFRS 17, paragraph 62 of IFRS 17 requires an entity to recognise a reinsurance contract held that provides proportionate coverage at the later of the beginning of the coverage period or initial recognition of the first underlying insurance contract.

60. When developing the proposed amendment, the Board observed that some stakeholders had interpreted the explanation of proportionate coverage in paragraph BC304 of the Basis for Conclusions on IFRS 17 differently to what the Board intended. The proposed footnote was intended to clarify the Board's original intention and would be consistent with the proposed definition of proportionate coverage in the Exposure Draft. However, the staff note that the footnote would no longer be necessary in the context of the proposed amendment if the Board were to agree with the staff recommendation that the proposed amendment apply to all reinsurance contracts held (see paragraph 42 of this paper). In addition, in the light of the feedback from outreach and comment letters, the staff think that adding the footnote at this

stage of implementation would likely disrupt rather than support implementation. Therefore, the staff recommend the Board does not add the proposed footnote to paragraph BC304 of the Basis for Conclusions on IFRS 17.

Timing of entering into the reinsurance contract held

61. As discussed in paragraph 25 of this paper, a small number of respondents expressed concerns that the proposed amendment would not apply when a reinsurance contract held is recognised after a loss is recognised on initial recognition of an underlying insurance contract. As explained in paragraph BC85 of the Basis for Conclusions on the Exposure Draft, the Board concluded that such a condition is necessary to ensure that the recovery of losses is recognised at the same time as the losses. In the staff view, the Board's rationale continues to hold. An accounting mismatch cannot exist on initial recognition of a loss on an underlying insurance contract if the reinsurance contract held does not exist at the time the loss is recognised. In addition, as discussed in paragraph 54 of this paper, this condition would limit the possibility of abuse of the proposed amendment. Therefore, the staff recommend the Board confirm that the amendment to IFRS 17 would apply only when the reinsurance contract held is recognised before or at the same time as the loss is recognised on the underlying insurance contracts.

Guidance on the loss-recovery component

62. As discussed in paragraph 26 of this paper, a small number of respondents asked for guidance on the loss-recovery component of a group of reinsurance contracts held. Tracking a loss-recovery component of a group of reinsurance contracts held is necessary both when applying:

(a) the proposed amendment in the Exposure Draft; and

(b) paragraph 66(c)(ii) of IFRS 17 for subsequent measurement.

63. The loss-recovery component of a group of reinsurance contracts held is akin to the loss component of a group of insurance contracts issued and, therefore, is accounted for in a consistent manner. The staff will consider either extending the illustrative example accompanying the Exposure Draft or providing educational material on the

treatment of a loss-recovery component to provide guidance on the measurement of the loss-recovery component.

Premium allocation approach

64. As discussed in paragraph 27 of this paper, a small number of respondents said that while the proposed amendment would apply when underlying insurance contracts are measured applying the general model or the premium allocation approach, the requirement in paragraph 66(c)(ii) of IFRS 17 for subsequent measurement appears to apply only when underlying insurance contracts are measured applying the general model. That paragraph refers to the contractual service margin of the underlying insurance contracts. The measurement of insurance contracts applying the premium allocation approach does not include a contractual service margin. In the staff view, the Board intended that paragraph to apply also when underlying insurance contracts are measured applying the premium allocation approach. However, the staff think the premium allocation approach was overlooked in the drafting. Therefore, the staff recommend the Board clarify, in the final amendments to IFRS 17, that paragraph 66(c)(ii) of IFRS 17—for subsequent measurement of a group of reinsurance contracts held when a group of underlying insurance contracts become onerous—applies when underlying insurance contracts are measured applying the premium allocation approach.

Question 3 for Board members

Do you agree the Board should:

(a) not add the proposed footnote to paragraph BC304 of the Basis for Conclusions on IFRS 17;

(b) confirm that the amendment to IFRS 17 would apply only when the reinsurance contract held is recognised before or at the same time as the loss is recognised on the underlying insurance contracts; and

(c) clarify, in the final amendments to IFRS 17, that paragraph 66(c)(ii) of IFRS 17—for subsequent measurement of a group of reinsurance contracts held when a group of underlying insurance contracts become onerous—applies when underlying insurance contracts are measured applying the premium allocation approach?

Appendix A—three examples of applying the proposed amendment in the Exposure Draft

Introduction

A1. This appendix provides three examples:

(a) Example 1—loss recovery is equal to net gain on reinsurance contract held;

(b) Example 2—loss recovery is more than net gain on reinsurance contract held; and

(c) Example 3—reinsurance contract held is in net cost position.

A2. In all three examples:

(a) a reinsurance contract held provides coverage for 40% of all claims on an underlying insurance contract that is onerous;

(b) the risk adjustment for non-financial risk and discounting are ignored for simplicity; and

(c) it is assumed that events occur as expected at initial recognition.

A3. For ease of reading, the amounts which differ between the three examples are shown in blue.

Example 1—loss recovery is equal to net gain on reinsurance contract held

A4. The premium charged by the reinsurer is proportionate to the premium charged by the entity. Expected cash flows at initial recognition are as follows:

Insurance contract issued		Reinsurance contract held		Total	
Premiums	100	Reinsurance premiums	(40)	Net premiums	60
Claims	(150)	Claim recoveries	60	Net claims	(90)
Loss	**(50)**	**Net gain**	**20**	**Net position**	**(30)**

A5. Applying IFRS 17 as originally issued, the amounts recognised in profit or loss would be calculated as follows:

IFRS 17 as originally issued	Recognised immediately	Recognised over time
Insurance revenue	-	100
Insurance service expenses	(50)	(100)
Insurance contracts issued	**(50)**	**-**
Reinsurance premiums	-	(40)
Amounts recovered from reinsurance	-	60
Reinsurance contracts held	**-**	**20**
Profit/(loss)	**(50)**	**20**

A6. Applying the proposed amendment in the Exposure Draft, the loss recovery would be CU20 (CU50 x 40%) and the amounts recognised in profit or loss would be calculated as follows:

Proposed amendment in the Exposure Draft	Recognised immediately	Recognised over time
Insurance revenue	-	100
Insurance service expenses	(50)	(100)
Insurance contracts issued	**(50)**	**-**
Reinsurance premiums	-	(40)
Amounts recovered from reinsurance	20	40
Reinsurance contracts held	**20**	**-**
Profit/(loss)	**(30)**	**-**

Example 2—loss recovery is more than net gain on reinsurance contract held

A7. The premium charged by the reinsurer is not proportionate to the premium charged by the entity. Instead the reinsurer charges a higher premium than in Example 1. Expected cash flows at initial recognition are as follows:

Insurance contract issued		**Reinsurance contract held**		**Total**	
Premiums	100	Reinsurance premiums	(52)	Net premiums	48
Claims	(150)	Claim recoveries	60	Net claims	(90)
Loss	**(50)**	**Net gain**	**8**	**Net position**	**(42)**

A8. Applying IFRS 17 as originally issued, the amounts recognised in profit or loss would be calculated as follows:

IFRS 17 as originally issued	**Recognised immediately**	**Recognised over time**
Insurance revenue	-	100
Insurance service expenses	(50)	(100)
Insurance contracts issued	**(50)**	**-**
Reinsurance premiums	-	(52)
Amounts recovered from reinsurance	-	60
Reinsurance contracts held	**-**	**8**
Profit/(loss)	**(50)**	**8**

A9. Applying the proposed amendment in the Exposure Draft, the loss recovery would be CU20 (CU50 x 40%) and the amounts recognised in profit or loss would be calculated as follows:

Proposed amendment in the Exposure Draft	**Recognised immediately**	**Recognised over time**
Insurance revenue	-	100
Insurance service expenses	(50)	(100)
Insurance contracts issued	**(50)**	**-**
Reinsurance premiums	-	(52)
Amounts recovered from reinsurance	20	40
Reinsurance contracts held	**20**	**(12)**
Profit/(loss)	**(30)**	**(12)**

Example 3—reinsurance contract held is in net cost position

A10. The premium charged by the reinsurer is not proportionate to the premium charged by the entity. Instead the reinsurer charges a higher premium than in Example 1 and Example 2. Expected cash flows at initial recognition are as follows:

Insurance contract issued		**Reinsurance contract held**		**Total**	
Premiums	100	Reinsurance premiums	(65)	Net premiums	35
Claims	(150)	Claim recoveries	60	Net claims	(90)
Loss	**(50)**	**Net cost**	**(5)**	**Net position**	**(55)**

A11. Applying IFRS 17 as originally issued, the amounts recognised in profit or loss would be calculated as follows:

Applying IFRS 17 as originally issued	**Recognised immediately**	**Recognised over time**
Insurance revenue	-	100
Insurance service expenses	(50)	(100)
Insurance contracts issued	**(50)**	**-**
Reinsurance premiums	-	(65)
Amounts recovered from reinsurance	-	60
Reinsurance contracts held	**-**	**(5)**
Profit/(loss)	**(50)**	**(5)**

A12. Applying the proposed amendment in the Exposure Draft, the loss recovery would be CU20 (CU50 x 40%) and the amounts recognised in profit or loss would be calculated as follows:

Proposed amendment in the Exposure Draft	**Recognised immediately**	**Recognised over time**
Insurance revenue	-	100
Insurance service expenses	(50)	(100)
Insurance contracts issued	**(50)**	**-**
Reinsurance premiums	-	(65)
Amounts recovered from reinsurance	20	40
Reinsurance contracts held	**20**	**(25)**
Profit/(loss)	**(30)**	**(25)**