STAFF PAPER

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Project	**Disclosure Initiative—Subsidiaries that are SMEs**
Paper topic	IFRS 17 *Insurance Contracts*

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Introduction

1. As discussed in Agenda Paper 31 *Cover Paper* the International Accounting Standards Board (Board) is considering proposing an IFRS Standard that will permit subsidiaries that are small and medium-sized entities (SMEs) to apply IFRS Standards with reduced disclosure requirements (reduced–disclosure IFRS Standard).

2. This paper considers whether, if the Board decides to propose a reduced–disclosure IFRS Standard, the proposals should include disclosure requirements for insurance contracts within the scope of IFRS 17 *Insurance Contracts*.

3. This agenda paper is structured as follows:

   (a) Background:

      (i) specialised activities requirements in the *IFRS for SMEs* Standard (paragraphs 4–7);

      (ii) effective date and scope of IFRS 17 (paragraphs 8–10); and

      (iii) could subsidiaries that are SMEs issue insurance contracts within the scope of IFRS 17 (paragraphs 11–16)?

   (b) Possible approaches and a question for Board members (paragraphs 17–28).

Background

Specialised activities requirements in the IFRS for SMEs Standard

4. The *IFRS for SMEs* Standard includes requirements on three types of specialised activities; they are agricultural activities, extractive activities and service concessions. Applying the agreed approach, the staff have analysed the requirements of the *IFRS for SMEs* Standard and IFRS Standards for these activities and prepared suggested disclosure requirements for agricultural activities and extractive industries. Applying the agreed approach, no disclosure requirements specific to service concessions are proposed; the disclosure requirements that will be required by the reduced–disclosure IFRS Standard for topics such as revenue and intangible assets will be applicable.

5. IFRS 14 *Regulatory Deferral Accounts* and IFRS 17 are both IFRS Standards that apply to entities performing specialised activities. Some entities performing these specialised activities could meet the definition of an SME; however, at present the *IFRS for SMEs* Standard contains no requirements relating to IFRS 14 or IFRS 17. The Board has an active project on Rate-regulated Activities which could lead to the replacement of IFRS 14. IFRS 17 is not yet effective and is outside the scope of the Second Comprehensive Review of the *IFRS for SMEs* Standard.

6. At its November 2020 meeting, the Board tentatively decided that, if it proposes a reduced-disclosure IFRS Standard, the proposals should include disclosure requirements for regulatory deferral account balances.

7. This paper completes the discussion on possible reduced disclosure requirements for specialised activities by considering whether, if the Board proposes a reduced-disclosure IFRS Standard, the proposals should include disclosure requirements for insurance contracts within the scope of IFRS 17.

Effective date and scope of IFRS 17

8. IFRS 17 is effective for annual reporting periods beginning on or after 1 January 2023. Early application is permitted if the entity also applies IFRS 9 *Financial*

Instruments.[1] At present, the staff are not aware of any entities that have, or are planning to, early adopt IFRS 17.

9. IFRS 17 applies to:

   (a) insurance contracts, including reinsurance contracts, an entity issues;

   (b) reinsurance contracts an entity holds; and

   (c) investment contracts with discretionary participation features an entity issues, provided the entity also issues insurance contracts.

10. Contracts that meet the IFRS 17 definition of an insurance contract can be issued by insurance entities or other entities, ie, the requirements of IFRS 17 do not only apply to insurance entities. However, IFRS 17 specifies some scope exclusions that generally relate to contracts typically issued by non-insurance entities, for example, warranties provided by a manufacturer, dealer or retailer in connection with the sale of goods or services to a customer.

Could subsidiaries that are SMEs issue insurance contracts within the scope of IFRS 17?

11. An SME is described in paragraphs 1.2 and 1.3 of the *IFRS for SMEs* Standard; these paragraphs are reproduced in Appendix A to Agenda Paper 31.

12. An entity that has public accountability does not meet the definition of an SME. Paragraph 1.3(b) of the *IFRS for SMEs* Standard states that an entity has public accountability if:

    > it holds assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses (most banks, credit unions, insurance companies, securities brokers/dealers, mutual funds and investment banks would meet this second criterion).

[1] Some insurers qualify for a temporary exemption from IFRS 9 *Financial Instruments*.

13. The SME Implementation Group (SMEIG) issued a Q&A[2] in 2011 on the topic of entities that typically have public accountability. The guidance in the Q&A has been incorporated into education material about the *IFRS for SMEs* Standard that is available on the IFRS Foundation website. The education material explains that:

> A captive insurance company is typically an insurance company that insures only the risks of a single entity (often its parent company) or only the risks of entities within the same group of entities as the captive insurance company (such as fellow subsidiaries or parent entities). Where this is the case, the captive insurance company holds assets in a fiduciary capacity only for other group entities, which would not be considered a broad group of outsiders. Consequently, the captive insurance subsidiary is not publicly accountable, and the group will not be publicly accountable solely as a result of the captive insurance subsidiary.

14. The staff note that a captive insurance company could be an entity that provides insurance to non-insurance entities in the same group, or it could be an entity that provides reinsurance to insurance entities in the same group.

15. Paragraph BC255(a) of the *IFRS for SMEs* Standard explains that one of the minor amendments to the *IFRS for SMEs* Standard made in 2015 was 'clarification that the entities listed in paragraph 1.3(b) are not automatically publicly accountable'.

16. We are unaware of the size of the population of subsidiaries that both issue insurance contracts and qualify as SMEs and thus may be eligible to apply the reduced-disclosure IFRS Standard. However, we know that some subsidiaries that, if they apply IFRS Standards, would apply IFRS 17 and would be eligible to apply the reduced-disclosure IFRS Standard, for example, some captive insurance entities (see paragraph 13). In addition, non-insurance entities that issue contracts within the scope of IFRS 17 may qualify as SMEs.

[2] Q&As are published by the SMEIG and are intended to provide non-mandatory guidance to address application issues on the *IFRS for SMEs* Standard. All Q&As issued prior to the issue of the 2015 amendments to the *IFRS for SMEs* Standard were either incorporated in the *IFRS for SMEs* Standard as a result of those amendments and/or included in education materials.

Possible approaches

17. At its November 2020 meeting, the Board tentatively decided that should it propose a reduced-disclosure IFRS Standard, the consultation document should include disclosure requirements related to IFRS Standards issued as at 1 January 2021. Accordingly, the consultation document should propose reduced-disclosure requirements for insurance contracts in the scope of IFRS 17 unless there are factors specific to IFRS 17 that suggest otherwise. If the Board does not propose reduced disclosure requirements an entity applying the reduced-disclosure IFRS Standard and issuing insurance contracts in the scope of IFRS 17 would be required to apply all the IFRS 17 disclosure requirements. Paragraphs 18–28 of this paper consider whether there are any factors specific to IFRS 17 that indicate the Board should not propose reduced-disclosure requirements for IFRS 17.

18. IFRS 17 is the only IFRS Standard issued but not effective that could be included in the consultation document. Many entities are in the advanced stage of implementing the Standard, including introducing systems changes for recognition, measurement and disclosure. Proposing reduced disclosure requirements now could risk disrupting IFRS 17 implementation for some entities, due to possible system adaptations needed for reduced disclosures. However, as disclosure requirements proposed in the reduced–disclosure IFRS Standard would be a reduced version of IFRS 17's disclosure requirements, rather than new disclosure requirements, the disruption should be minimal.

19. IFRS 17 introduces a new recognition and measurement model for insurance contracts which is supported by its disclosure requirements. If a subsidiary has material insurance contracts then in the early years of application of IFRS 17 users' interests may be best served by having the full IFRS 17 disclosures. Providing all the disclosures should facilitate their understanding of the new model.

20. Deferring proposing reduced disclosure requirements until after entities have applied IFRS 17 for a period of time would allow users to increase their familiarity with the new model and its impact on an entity's financial statements whilst allowing the Board to assess the effectiveness of the disclosure requirements before proposing reduced disclosure requirements.

21. The Board might consider alignment of the *IFRS for SMEs* Standard with IFRS 17 in the third comprehensive review of the *IFRS for SMEs* Standard. If so, the Board might wish to simultaneously consider whether to include disclosure requirements for IFRS 17in the reduced-disclosure IFRS Standard.

22. However, deferring proposing reduced disclosure requirements until after entities have applied IFRS 17 for a period of time would result in entities being required to implement and apply the IFRS 17 disclosure requirements in full for only a short period of time. This could be seen as an unnecessary cost and burden for those entities. Although, as disclosure requirements proposed in the reduced–disclosure IFRS Standard would be a reduced version of IFRS 17's disclosure requirements, the costs would be minimised and may not outweigh the benefits to users of having the full disclosures in the first years of IFRS 17 application.

23. In addition, if the Board decides to publish an Exposure Draft of a reduced–disclosure IFRS Standard *without* proposing reduced disclosures for insurance contracts, it could receive persuasive feedback that the Board add such requirements. Any proposals the Board might make for reduced disclosures for insurance contracts would need to be subject to public consultation. Thus, proposing reduced disclosure requirements now could avoid the risk of re-exposure and the inevitable delay that would introduce. Such delay could create additional uncertainty for those implementing IFRS 17.

24. The remainder of the analysis in this paper considers how the IFRS 17 disclosure requirements could be reduced, and whether such reductions would provide meaningful relief for entities applying the reduced-disclosure IFRS Standard (ie is standard-setting worthwhile).

25. As noted in Agenda Paper 31, the Board tentatively decided that the disclosure requirements of the *IFRS for SMEs* Standard will be the starting point for the disclosure requirements of the reduced-disclosure IFRS Standard. However, the *IFRS for SMEs* Standard does not include requirements for insurance contracts and thereby does not include disclosure requirements for insurance contracts. To be consistent with the approach taken in this project when the *IFRS for SME* Standard and IFRS Standards contain different recognition and measurement requirements, the principles in paragraph BC157 of the *IFRS for SMEs* Standard (reproduced in paragraph 27 of this paper) would be applied to the IFRS 17 disclosure requirements.

However, as many insurance entities are regulated entities and an insurance regulator is one of the primary users of their financial statements, there is an argument for also considering other factors. The preliminary analysis in this paper considers only the principles in paragraph BC157 of the *IFRS for SMEs* Standard.

26. The IFRS 17 disclosure requirements can be categorised as follows:

(a) disclosure objective (paragraphs 93–96 of IFRS 17);

(b) explanation of recognised amounts (paragraphs 97–114 of IFRS 17);

(c) significant judgements in applying IFRS 17 (paragraphs 117–120 of IFRS 17); and

(d) nature and extent of risks that arise from contracts within the scope of IFRS 17 (paragraphs 121–132 of IFRS 17).

27. The following table sets out the staff's preliminary thoughts on applying the principles in paragraph BC157 of the *IFRS for SM*Es Standard to the IFRS 17 disclosure requirements.

Principle in paragraph BC157 of the *IFRS for SMEs* Standard	**Preliminary thoughts on applying principle to IFRS 17 disclosure requirements**
A. Users of the financial statements of SMEs are particularly interested in information about short-term cash flows and about obligations, commitments or contingencies, whether or not recognised as liabilities. Disclosures in full IFRSs that provide this sort of information are necessary for SMEs as well.	All of the IFRS 17 disclosure requirements relate to obligations that are recognised as liabilities.
B. Users of the financial statements of SMEs are particularly interested in information about liquidity and solvency. Disclosures in full IFRSs that provide this sort of information are necessary for SMEs as well.	The **nature and extent of risks that arise from contracts within the scope of IFRS 17** disclosure requirements provide information about liquidity risk.

C. Information on measurement uncertainties is important for SMEs.	The **significant judgements in applying IFRS 17** and **nature and extent of risks arising from contracts within the scope of IFRS 17** disclosure requirements assist users in understanding the uncertainty in the measurement of insurance contract liabilities.
D. Information about an entity's accounting policy choices is important for SMEs	The **significant judgements in applying IFRS 17** disclosure requirements include disclosures about accounting policy choices (for example, the accounting policy choice to disaggregate insurance finance income or expenses between profit or loss and OCI).
E. Disaggregations of amounts presented in SMEs' financial statements are important for an understanding of those statements.	The **explanation of recognised amounts** disclosure requirements include reconciliations of changes in insurance contract liabilities.
F. Some disclosures in full IFRSs are more relevant to investment decisions in public capital markets than to the transactions and other events and conditions encountered by typical SMEs.	All of the IFRS 17 disclosure requirements assist users of financial statements in understanding the measurement of insurance contract liabilities.

28. In the light of the preliminary thoughts set out in the table above, the staff think that if the Board proposed reduced disclosure requirements for insurance contracts, then applying the principles in paragraph BC157 of the *IFRS for SMEs* Standard—without yet considering the specific needs of insurance regulators that might go beyond the needs set out in paragraph BC157 (see paragraph 25 of this paper)—those disclosure

requirements would not be significantly reduced compared to the IFRS 17 disclosure requirements. That said, some reductions are possible. For example, based on staff's preliminary analysis the following adaptions could be possible:

(a) the disclosure objectives in the IFRS 17 disclosure requirements could be deleted (consistent with the approach for other IFRS Standards as tentatively decided at the November 2020 Board meeting).

(b) some of the required disclosures could be simplified, similar to how disclosure requirements of other IFRS Standards are simplified in the *IFRS for SME* Standard. To use an example, paragraph 106 of IFRS 17 requires an entity to disclose an analysis of insurance revenue and specifies what that analysis must comprise. That requirement could be adapted by deleting the specific items that the analysis need comprise, but retaining the requirement for an analysis. Such simplifications would be consistent with how disclosure requirements have been simplified in the *IFRS for SMEs* Standard; arguably this would give consistency in the level of granularity specified in the disclosure requirements applied by entities applying the reduced-disclosure IFRS Standard, although such simplifications do not result from application of the principles in paragraph BC157. However, this would involve a risk that entities do not provide sufficient disaggregation about insurance contract liabilities.

(c) paragraph 109A of IFRS 17 requires an entity to disclose information about when in the future it expects to derecognise any assets for insurance acquisition cash flows. Applying the principles in paragraph BC157 of the *IFRS for SME* Standard the staff think that this requirement could be excluded because it is about recognition of expenses, and this is not necessarily linked to when the cash flows arise.

(d) paragraphs 111–113 of IFRS 17 provide disclosure requirements specific to insurance contracts with direct participation features. The staff expect that an entity issuing such contracts would not qualify as an SME and thus these requirements would not be applicable.

Question for the Board

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If the Board decides to propose a reduced–disclosure IFRS Standard, should the consultation document include proposed reduced disclosure requirements for IFRS 17?