IFRS

STAFF PAPER

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Project	**Amendments to IFRS 17**		
Paper topic	Other topics raised by respondents to the Exposure Draft *Amendments to IFRS 17*		
CONTACT(S)	Vitalina Kobernik	vkobernik@ifrs.org	+44 (0)20 7246 6919
	Anne McGeachin	amcgeachin@ifrs.org	+44 (0)20 7246 6486

Purpose of the paper

1. This paper provides staff analysis and recommendations on feedback from respondents to the Exposure Draft *Amendments to IFRS 17* relating to the areas of IFRS 17 *Insurance Contracts* that the International Accounting Standards Board (Board) did not consider when developing the Exposure Draft. As anticipated at the November 2019 Board meeting, this paper includes analysis of the new concerns and implementation questions raised by respondents so that the Board can decide what, if any, action is needed to address them.

Summary of staff recommendations

2. The staff recommend the Board:

   (a) amend paragraph B66(f) of IFRS 17 to resolve an inconsistency between that paragraph and paragraph B65(m) of IFRS 17. After that amendment, an entity would apply paragraph B65(m) of IFRS 17 to include in the fulfilment cash flows the income tax payments and receipts that are specifically chargeable to the policyholder under the terms of an insurance contract.

   (b) retain, unchanged, the requirements in paragraph B113(b) of IFRS 17. That paragraph requires an entity to adjust the contractual service margin of insurance contracts with direct participation features for the changes in the effect of the time value of money and financial risks not arising from the underlying items.

(c) not add any new requirements to IFRS 17 or publish any educational material relating to the accounting for insurance contracts that change their nature over time.

(d) retain, unchanged, the requirements in IFRS 17 relating to the other topics discussed in Appendix A to this paper.

Structure of the paper

3. As noted in the comment letter summary considered by the Board at its November 2019 meeting,[1] some respondents commented on areas of IFRS 17 that the Board did not consider when developing the Exposure Draft. This paper provides an overview of the feedback, the staff analysis, recommendations and questions for the Board for the following topics:

(a) treatment of policyholder taxes applying IFRS 17 (see paragraphs 4–17 of this paper);

(b) treatment of specific cash flows in the variable fee approach (see paragraphs 18–25 of this paper), including:

(i) application of the requirements in paragraph B113(b) of IFRS 17; and

(ii) contracts that change their nature over time;

(c) other topics (see paragraphs 26–28 of this paper and Appendix A to this paper).

[1] See Agenda Paper 2C *Comment letter summary—other comments.*

Treatment of policyholder taxes applying IFRS 17

Feedback

4. Paragraph B66(f) of IFRS 17 specifies that an entity does not include in the fulfilment cash flows income tax payments and receipts unless the entity pays or receives them in a fiduciary capacity. Some respondents questioned whether that requirement contradicts paragraph B65(m) of IFRS 17. Applying paragraph B65(m) of IFRS 17, an entity includes in the fulfilment cash flows any costs specifically chargeable to the policyholder under the terms of the contract.

5. Those respondents said that, in some cases income tax paid by an entity, even though not paid in a fiduciary capacity, is specifically chargeable to the policyholder under the terms of the contract. They expressed the view that such a tax should be included in the fulfilment cash flows. Such a tax, which is described as a *policyholder tax* in this paper, arises for example when an entity:

    (a) pays income tax on assets that are underlying items to insurance contracts; and

    (b) charges the policyholder for its share of that income tax.

6. Those respondents also noted that, applying paragraph B66(f) of IFRS 17, an entity will typically exclude from the fulfilment cash flows the income tax payments described in paragraph 5(a) of this paper because those income taxes are not paid by the entity in a fiduciary capacity. However, applying paragraph B65(c) of IFRS 17, an entity will include in the fulfilment cash flows the reimbursement of such income tax payments described in paragraph 5(b) of this paper. Those respondents perceive this to be an accounting mismatch.

7. To address the concerns described in paragraphs 4–6 of this paper, some respondents suggested the Board amend IFRS 17 to explicitly include income tax payments described in the paragraph 5 of this paper in the fulfilment cash flows.

Staff analysis and recommendation

8. The staff agree with respondents that there is a contradiction between the requirements in paragraphs B65(m) and B66(f) of IFRS 17. The staff note that the contradiction results in an inconsistent treatment and different recognition pattern and timing of the following amounts:

   (a) income tax payments not paid in a fiduciary capacity, which are excluded from the fulfilment cash flows applying paragraph B66(f) of IFRS 17; and

   (b) the reimbursement of such income tax payments, which are included in the fulfilment cash flows applying paragraph B65(c) of IFRS 17.

9. This is because an entity would recognise:

   (a) income tax expense when the entity recognises investment income on the underlying items; and

   (b) any reimbursement of the income tax expense over the period of time during which the entity provides insurance contract services to the policyholder.

10. The staff think that when a cost is specifically chargeable to a policyholder, the cash flows that the entity will receive will vary depending on:

    (a) whether the cost is incurred; and

    (b) the amount of the incurred cost.

11. By accepting such a charge, the policyholder bears all the risks associated with those costs, and the entity none. In relation to the income tax payments described in paragraph 5 of this paper, no profit will arise for the entity because cash outflows (income tax payments to the tax authority) will always result in equal cash inflows (reimbursement of income tax charged to a policyholder).

12. Given that the income tax payments described in paragraph 5 of this paper are specifically chargeable to the policyholder under the terms of the contract, the staff think that the entity should include such income tax payments in the fulfilment cash flows applying the requirements of paragraph B65(m) of IFRS 17. In addition, the

staff note the entity already includes the reimbursement of such income tax in the fulfilment cash flows applying paragraph B65(c) of IFRS 17.

13. The staff considered whether amending paragraph B66(f) of IFRS 17 could result in an entity including any amount of income taxes in the fulfilment cash flows. It could be argued that income tax is in effect charged to a policyholder whenever the price for the contract is set to give an after-tax profit. However, the staff observe that in this case the entity bears *all* the risk from any changes in tax rates or legislation affecting income tax payments because the income tax is not specifically chargeable to a policyholder.

Interaction with the requirements of IAS 12 Income Taxes

14. The staff considered how including some amounts of income tax in the fulfilment cash flows would interact with the requirements of IAS 12 *Income Taxes*. The staff observe that an entity will continue to apply IAS 12 to those income tax payments to measure:

    (a) the amounts of such income tax payments to be included in the fulfilment cash flows; and

    (b) the amounts of income taxes to be incurred in profit and loss.

15. This is consistent with IFRS 17 requirements for other amounts included in the fulfilment cash flows. For example, an entity might include building depreciation costs in the fulfilment cash flows applying paragraph B65(l) of IFRS 17. The entity will determine depreciation costs over the period of the useful life of the building applying the requirements of IAS 16 *Property, Plant and Equipment*. The entity will include those expected costs in the fulfilment cash flows. When those costs are incurred applying IAS 16 the entity will treat them as an incurred expense under IFRS 17, ie the entity will reduce the liability for remaining coverage and recognise revenue. Similarly, for the income tax payments specifically chargeable to policyholders under the contract terms—when the tax expense is incurred applying IAS 12 the entity will treat it as an incurred expense applying IFRS 17.

Staff recommendation

16. In the light of the analysis in paragraphs 8–15 of this paper, the staff recommend the Board amend paragraph B66(f) of IFRS 17 to resolve an inconsistency between that

paragraph and paragraph B65(m) of IFRS 17. After that amendment, an entity would apply paragraph B65(m) of IFRS 17 to include in the fulfilment cash flows the income tax payments and receipts that are specifically chargeable to the policyholder under the terms of an insurance contract.

17. Paragraph B66(f) of IFRS 17 would become:

> income tax payments and receipts that are not specifically chargeable to the policyholder under the terms of the contract ~~the insurer does not pay or receive in a fiduciary capacity. Such payments and receipts are recognised, measured and presented separately applying IAS 12 Income Taxes~~.

Question 1 for Board members
Do you agree the Board should amend paragraph B66(f) of IFRS 17 to resolve an inconsistency between that paragraph and paragraph B65(m) of IFRS 17? After that amendment, an entity would apply paragraph B65(m) of IFRS 17 to include in the fulfilment cash flows the income tax payments and receipts that are specifically chargeable to the policyholder under the terms of an insurance contract.

Treatment of specific cash flows in the variable fee approach

Feedback

Application of the requirements in paragraph B113(b) of IFRS 17

18. For insurance contracts without direct participation features (ie contracts to which the general model applies), changes in the fulfilment cash flows that are changes in the effect of the time value of money and financial risks are recognised in profit or loss (or in other comprehensive income) as insurance finance income or expenses. In contrast, for insurance contracts with direct participation features (ie contracts to which the variable fee approach applies), paragraph B113(b) of IFRS 17 requires those changes not arising from underlying items to adjust the contractual service margin.

19. Some respondents expressed concerns about applying the requirement in paragraph B113(b) of IFRS 17 to variable fee approach contracts that include cash flows that are not cash flows from the participation in underlying items (ie non-trivial fixed cash flows) such as insurance claims or financial guarantees. Those stakeholders are concerned that:

(a) changes in the effect of the time value of money and financial risks that in the general model are recognised as an expense in profit or loss (or in other comprehensive income) will, in the variable fee approach, adjust the contractual service margin. One respondent expressed concern that those adjustments to the contractual service margin could result in a group of variable fee approach contracts becoming onerous.

(b) those changes adjust the contractual service margin but changes in assets that the entity holds to back the fixed cash flows are recognised in in profit or loss (or in other comprehensive income). Those respondents perceive this to be an accounting mismatch.

Contracts that change their nature over time

20. Some respondents said that an accounting mismatch could also arise from a contract that changes in nature over time. In particular, such a contract could change its nature due to the policyholder exercising an option. An example of such a contract is a contract with a savings phase with profit sharing that provides the policyholder with an option to subsequently convert the account balance into an annuity at a guaranteed rate. At inception, that contract might meet the scope of the variable fee approach. Subsequently, when the policyholder exercises the annuity option, the entity will still be required to continue applying the variable fee approach. In contrast, at inception of an annuity contract without a savings phase the entity would normally apply the general model.

21. These respondents suggested the Board amend IFRS 17 to require an entity to account for the contract described in paragraph 20 of this paper:

(a) applying the variable fee approach from inception until the policyholder exercises the annuity option; and

(b) applying the general model once the annuity option is exercised.

Staff analysis and recommendation

22. Respondents provided several suggestions to amend IFRS 17 relating to either:

    (a) applying paragraph B113(b) of IFRS 17 for changes in the time value of money and financial risk not arising from underlying items (paragraphs 18–19 of this paper); or

    (b) contracts that change their nature over time (paragraphs 20–21 of this paper).

23. Respondents suggested amending IFRS 17 to:

    (a) exclude cash flows generated from exercising some options from the contract boundary;

    (b) provide an accounting election to separate some components of an insurance contract;

    (c) make the requirements in paragraph B113(b) of IFRS 17 optional;

    (d) provide additional guidance on underlying items; or

    (e) expand the risk mitigation option for the use of non-derivative financial instruments at fair value through profit and loss.[2]

24. The staff observe that different respondents favour different suggested ways of amending IFRS 17. Further, the amendments suggested in paragraphs 23(a)–23(c) of this paper touch on key aspects of IFRS 17. As such, the staff think there could be unintended consequences from adopting these suggestions. This is the case even though some respondents suggested making the amendments in paragraphs 23(b) and 23(c) of this paper optional. The staff think that such options would significantly reduce comparability across entities and would increase the complexity of IFRS 17. In addition, the staff note that providing further application guidance as suggested in paragraph 23(d) of this paper, or educational material, could be disruptive at this stage of IFRS 17 implementation.

[2] The staff note that this suggestion was made by some respondents after discussions with those respondents on the comment letters they submitted.

25. The staff observe that the suggestion in paragraph 23(e) of this paper has been included in the staff recommendation in Agenda Paper 2C *Applicability of the risk mitigation option—non-derivative financial instruments at fair value through profit or loss* of this meeting. The staff recommendation in that paper addresses some of the concerns of the respondents discussed in this paper. The staff recommendation would permit an entity not to adjust the contractual service margin of insurance contracts with direct participation features for some effects of financial risk, subject to specific conditions being met.

Question 2 for Board members
Do you agree the Board should: (a) retain, unchanged, the requirements in paragraph B113(b) of IFRS 17; and (b) not add any new requirements to IFRS 17 or publish any educational material relating to the accounting for insurance contracts that change their nature over time?

Other topics

26. Appendix A to this paper discusses other topics raised by respondents that the Board did not consider when developing the Exposure Draft. Based on the analysis in Appendix A, the staff think no action is required by the Board in respect to these topics. The staff think that, at this stage, further changes to IFRS 17 are more likely to disrupt rather than help the implementation process.

27. In addition to the respondents' comments included in Appendix A, a small number of respondents made drafting suggestions. The staff will consider those suggestions when drafting the final amendments to IFRS 17.

28. Some respondents suggested the Board amend IFRS 17 to enhance disclosure requirements. However, the staff think that adding new disclosure requirements at this stage of IFRS 17 implementation could be unduly disruptive.

Question 3 for Board members
Do you agree the Board should retain, unchanged, the requirements in IFRS 17 relating to the other topics discussed in Appendix A to this paper?

Appendix A—Feedback and staff analysis on other topics raised

Topic	Feedback	Staff analysis
1—Participating contracts with underlying items that are non-participating contracts	Some respondents expressed concerns regarding accounting mismatches arising when the underlying items of variable fee approach contracts are non-participating insurance contracts. Applying IFRS 17: (a) the non-participating insurance contracts will be measured at fulfilment value plus the contractual service margin—ie applying the general model; and (b) the effect of the underlying items (ie the non-participating contracts described in (a)) on the variable fee approach contracts will be measured at fair value. Those respondents suggested the Board amend IFRS 17 to require an entity to measure non-participating contracts that are the underlying items of the variable fee approach contracts at fair value instead of being measured applying the general model.	In developing IFRS 17 the Board considered whether to require an entity to measure: (a) the effect of underlying items that are non-participating insurance contracts on contracts in the variable fee approach at the amount determined applying the general model to the non-participating contracts. The Board decided not to do so because that would be an exception to the variable fee approach. (b) non-participating contracts that are underlying items of variable fee approach contracts at fair value. The Board decided not to do so because that would be an exception to the general model. The staff note that the described exceptions would add significant complexity to IFRS 17. The staff think the Board should not change its previous conclusions because the previous reasons still apply and a change now could unduly disrupt implementation.

Topic	Feedback	Staff analysis
2—Guidance for specific areas of the Standard (including reinsurance contracts held and premium allocation approach)	A small number of respondents continued to request the Board provide further guidance on some areas of IFRS 17, including: (a) the accounting for reinsurance contracts held; and (b) the application of the premium allocation approach (for example, adding guidance on how to interpret the materiality criterion for the premium allocation approach eligibility test in paragraph 53(a) of IFRS 17 and providing specific requirements about the derecognition of insurance contracts accounted for applying the premium allocation approach).	The staff note that both the treatment of reinsurance contracts held and the application of the premium allocation approach are topics that the Board discussed extensively in developing IFRS 17. The staff think that providing further guidance on those areas is likely to unduly disrupt implementation of IFRS 17.

Topic	Feedback	Staff analysis
3—Requirements for reinsurance contracts held in paragraph 86(b) of IFRS 17	A small number of respondents disagreed with the requirement in paragraph 86(b) of IFRS 17 for reinsurance contracts held. Applying that requirement, ceding commissions that are not contingent on claims are treated as a reduction in the premiums to be paid to the reinsurer. One of those respondents suggested that the Board delete paragraph 86(b) of IFRS 17.	The staff note that paying a premium to the reinsurer of CU100[3] and receiving from the reinsurer a commission of CU20 (not contingent on claims) is, in effect, the same as paying to the reinsurer a premium of CU80. In the staff view, deleting paragraph 86(b) of IFRS 17 would cause inconsistency in the presentation of reinsurance contracts held. The staff also think that such a change would unduly disrupt implementation of IFRS 17.

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