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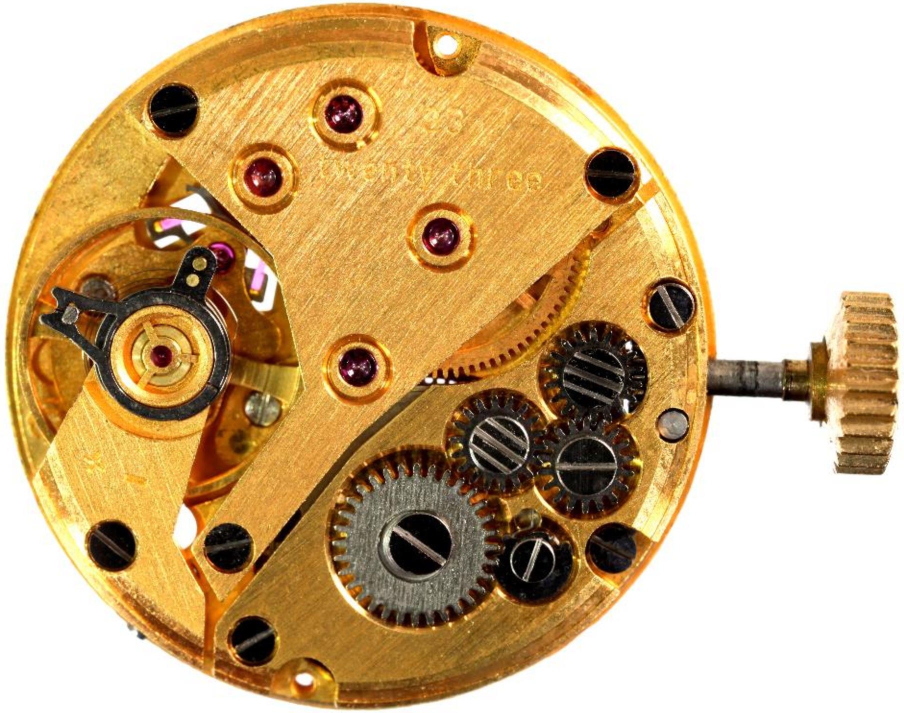


Reinsurance accounting for cedants has been improved

The IASB approves to finalise the first round of amendments to IFRS 17

Francesco Nagari, Deloitte Global IFRS Insurance Leader | 16 January 2020

Agenda

- Highlights of the IASB meeting on 11 December 2019
- Detailed analysis of the IASB discussions and decisions reached
- Next steps

Highlights of the IASB meeting on 11 December 2019

- The IASB discussed and **approved unanimously** to finalise the proposed amendments on the following topics:
  - Expected recovery of Insurance Acquisition Cash Flows (IACF):
    - Confirmation of the asset recognition and allocation principles as in the Exposure Draft
    - Decided that **the unit of account for IACF is a group of insurance contracts**.
    - **Added guidance on the recoverability of an asset for IACF before allocation** to a group to be done with a two-step impairment test.
    - Decided that in the balance sheet **any asset for IACF before allocation must be part of the carrying amount of the portfolios of insurance contracts issued** to which the IACF is related to.
  - Reinsurance contracts held—recovery of losses:
    - **Extend the scope of the proposed amendment to all types of reinsurance contracts held**
    - Decided a **relatively simple calculation basis for the reinsurance recovery in P&L** based on the percentage of recovery from the reinsurance contracts held.
  - Amendments proposed in the ED that the IASB tentatively decided in its meeting on 20 November 2019 **to confirm during this meeting** without the need of substantive deliberation. Some of these are important implementation requirements.

Expected recovery of Insurance Acquisition Cash Flows
Overview

- In response to comments received on the requirements for accounting of insurance acquisition cash flows (IACF), the IASB further discussed the following:

  - Allocation of IACF;
  - Recognition of an asset;
  - Impairment test (further discussions in subsequent slide);
  - Disclosures; and
  - Presentation.

- The IASB unanimously agreed on the Staff recommendations for each of the IACF areas discussed.

- They agreed to **finalise** the proposed amendments to IFRS 17 that would require an entity to allocate IACF that are directly attributable to a group of insurance contracts applying a systematic and rational method:

  (a) to that group; and
  (b) to any future groups that include contracts that are expected to arise from renewals of the contracts in that group.

  They clarified that once an entity allocates an IACF to a group of insurance contracts, they cannot be treated as a separate asset again. When allocated to a group, the IACF cannot be extracted from that group and reallocated to another.

- They also clarified that the asset will be shown in the same line item in the statement of financial position as the portfolio to which those future groups will be added, i.e. no separate presentation, only separate disclosures will be required.

Expected recovery of Insurance Acquisition Cash Flows

Overview

- The IASB agreed to finalise the proposed disclosure requirements to include:
    - **A reconciliation** from the opening to the closing balances of assets for IACF, showing separately any recognition of impairment losses and reversals of impairment losses; and
    - **Quantitative information**, in appropriate time-bands, about when an entity expects to derecognise an asset for IACF and include those cash flows in the measurement of the group of insurance contracts to which they are allocated.
- The transition reliefs for IACFs will be discussed in a separate paper of a future IASB meeting.

Expected recovery of Insurance Acquisition Cash Flows
Impairment test and unit of account

- Applying the proposed amendments to IFRS 17, an entity is required to perform the impairment test on assets for IACF only when facts and circumstances indicate that the asset may be impaired. In performing the impairment test, an entity is required to perform a two-step test:

  1. an impairment test at the level of a group of insurance contracts **(group level impairment test)** – where an impairment loss is recognized if the carrying amount of an asset for IACF allocated to a group is lower than the expected net cash inflow of the group.

  2. an additional impairment test specific to IACF allocated to expected contract renewals **(additional impairment test)** – where an impairment loss will be recognized on expected future renewals that are no longer expected to occur.

- Because some respondents suggested the IASB clarify the unit of account (UoA) for an asset for IACF, the IASB **decided that the UoA for an asset for IACF is the group of insurance contracts to which those cash flows have been allocated.**

Expected recovery of Insurance Acquisition Cash Flows

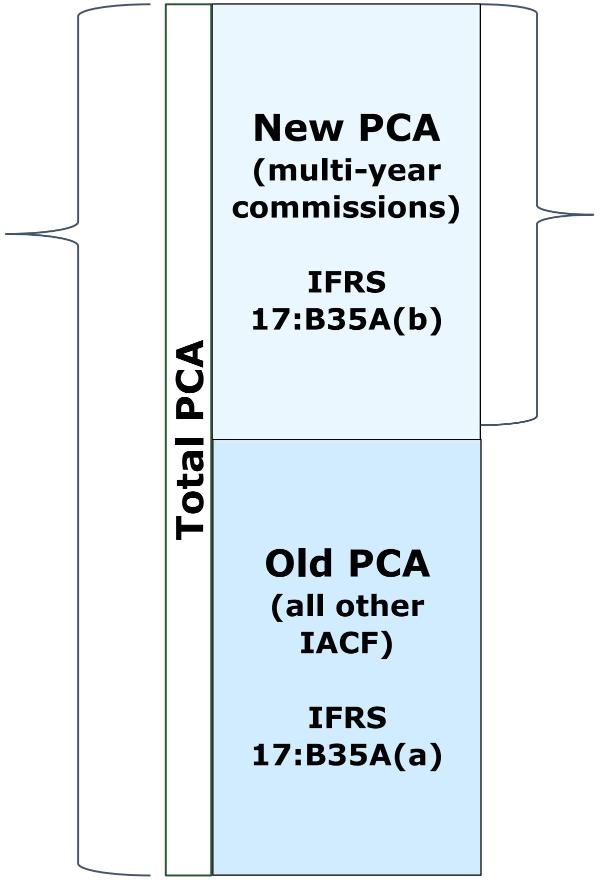
Impairment test – Interpretation of Staff's proposal

- There are two sections in those Pre-Coverage Assets (PCA):
  - One portion corresponds to the **old PCA from the original text of IFRS 17**, which includes **non-commission based** acquisition costs paid before the date of issue of the group of insurance contracts. The recoverable amount is from the total expected net cash inflows of both existing group (for contracts yet to be recognised into the group) and future groups.
  - Another portion corresponds to the **new PCA**, which are **commission-based** acquisition costs and specifically linked to net inflows from expected future renewals that are part of the expected net inflows of future groups.

A = Recoverable amount[2]
Impairment amount under B35B(a) if
A < Total PCA (New PCA+Old PCA)

[2]Expected net inflows from related group (*), inclusive of renewals and new business

(*) refers to both existing and future groups to which the IACF is allocated



B = Recoverable amount[1]
Additional impairment amount under B35B(b)
if B < New PCA

[1]Net inflows from expected renewals only

Expected recovery of Insurance Acquisition Cash Flows

Impairment test – Deloitte's comments

- Given that the UoA for an asset for IACF is the group of insurance contracts to which those cash flows have been allocated, **the guidance appears to be unclear as to whether the impairment tests would need to be applied to each of the group of insurance contracts and each of the future renewals.**

Future groups

0

+1y

+2y

+3y

+4y

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Interpretation not favoured by Deloitte

Impairment tests group 1

Impairment tests group 2

Impairment tests group 3

Impairment tests group 4

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Portfolio based PCA

Interpretation favoured by Deloitte

New PCA (multi-year commissions)

Renewals only net inflows recoverable amount

Old PCA (all other IACF)

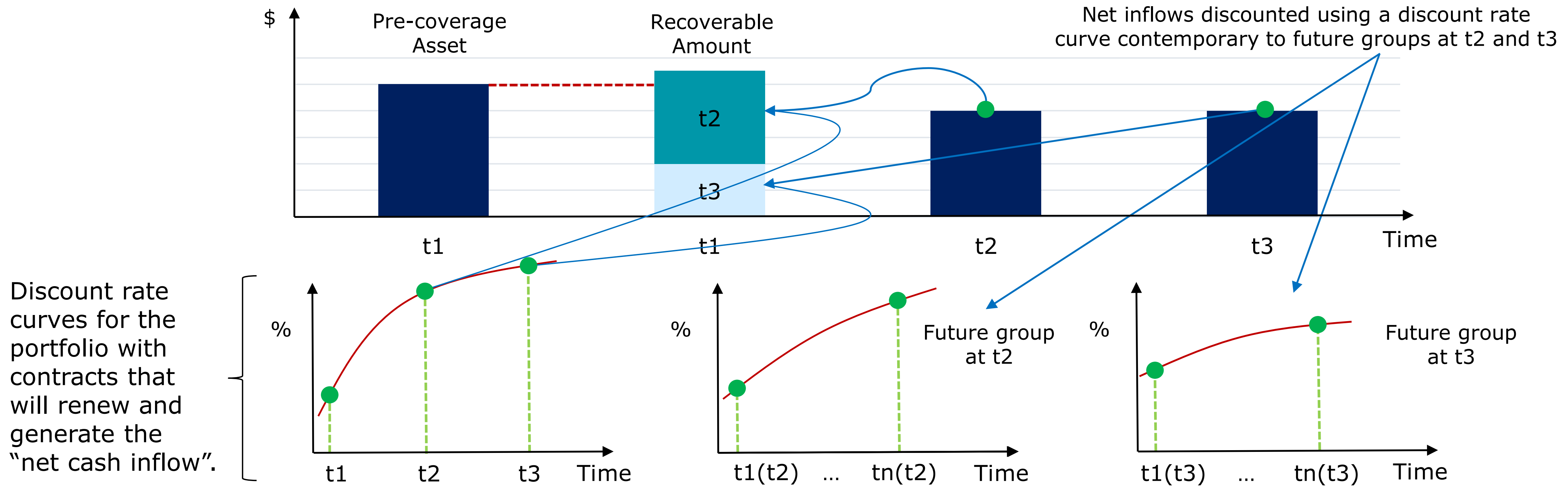
Renewals and NB net inflows recoverable amount

Expected recovery of Insurance Acquisition Cash Flows

Impairment test – Deloitte's comments

- Time Value of Money *(Deloitte Comment Letter): "We note that the impairment test for the insurance acquisition cash flows asset described in the proposed IFRS 17:B35B does not explicitly address whether it is necessary to take into account the time value of money. (…) We believe that more precise guidance on the effect of the time value of money in the impairment test is important."*

- There are 2 main consequences for no guidance on the effect of time value of money: the recoverable amount might be measured in a **different** and **material** way.



Reinsurance contracts held – recovery of losses
Overview

- The IASB further discussed the proposed amendments to IFRS 17 on the requirements for the recovery of losses on reinsurance contracts held. Topics include:
  - **extending the scope of the proposed amendments**, i.e. the proposed population of reinsurance contracts held to which the amendments would apply (discussed further in subsequent slide)
  - **amend the proposed calculation** of the amount to be recognized in income relating to recovery of losses from reinsurance contracts held (discussed further in subsequent slide)
- The IASB unanimously agreed on the Staff recommendations for each of the areas discussed.
- The IASB also decided to:
  - **Omit** the proposed footnote to paragraph BC304 of the Basis for Conclusions on IFRS 17 that provides a discussion that a reinsurance contract does not provide a proportionate coverage if the reinsurance contract held covers claims in excess of a specified amount on an individual insurance contract. This proposed omission is consequent to the decision made by the IASB on extending the scope of the proposed amendments relating to recovery of losses on reinsurance contracts held.
  - **Confirm** that the amendment to IFRS 17 applies only when the reinsurance contract held is recognized before or at the same time as the loss is recognized on the underlying insurance contracts.
  - **Clarify** that the requirement in IFRS 17:66(c)(ii) for subsequent measurement of a group of reinsurance contracts held when a group of underlying insurance contracts become onerous also applies when the underlying insurance contracts are measured applying the premium allocation approach.

Reinsurance contracts held–recovery of losses
Proposed calculation

Staff analysis and recommendations

<u>Calculation based on the connection between insurance claims and reinsurance claim recoveries</u>

- In Agenda Paper 2C, **Example 1** demonstrates the result of applying the proposed amendment in the ED when both **premiums** and **claims** are **proportionate** (in this case 40% of 50 = 20 recoverable from the reinsurance contract):

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 ED	Recognised immediately	Recognised over time
Insurance contracts issued	(50)	-
Reinsurance contracts held	20	-
Profit/(loss)	**(30)**	**-**

Reinsurance contracts held–recovery of losses

Proposed calculation

Staff analysis and recommendations (continued)

- **Example 3** demonstrate the results of applying the proposed amendment when premiums are **not proportionate** but the recovery from the reinsurance contract is still a proportion of the losses incurred by the cedant (40%).

- 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 ED	Recognised immediately	Recognised over time
Insurance contracts issued	(50)	-
Reinsurance contracts held	20	(25)
Profit/(loss)	**(30)**	**(25)**

- 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.

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

Reinsurance contracts held–recovery of losses
Proposed calculation

Staff analysis and recommendations (continued)

- Some respondents expressed concerns that in **Example 3** losses would not be visible to users of financial statements and the proposed amendment would be open to abuse. The IASB Staff produced the following example to explain the concerns:

An entity issues an insurance contract	**CU**
Premiums	280
Expected claims	-300
Onerous insurance contract: loss recognised	-20
This entity purchases a reinsurance contract held to recover 100% of underlying claims	**CU**
Reinsurance premium	300

- 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 and a net cost of CU20 would be recognised over time.

- 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.

Reinsurance contracts held–recovery of losses

Proposed calculation

Staff analysis and recommendations (continued)

- Considering all of the above, the Staff continue to hold the view that the new **loss-recovery calculation** 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.

IASB decision

- The IASB unanimously agreed to **amend** the proposed calculation of income, as a consequence of the extension of the scope of the proposed amendment, and to require cedants 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.

Proposed amendments to be finalised
Other amendments

Staff analysis and recommendations

- The Staff recommended the IASB finalise the following amendments as proposed in the ED because the feedback from outreach and comment letters provides support to finalise the proposals or because the Staff have not identified points the IASB has not considered previously:
  - CSM attributable to investment services—**coverage units for insurance contracts with DPF**;
  - Presentation in the statement of financial position at **portfolio instead of group level**;
  - **Transition reliefs** for liability for incurred claims acquired in business combinations during prior periods where full restatement is impracticable;
  - **Scope exclusion for loans that meet the definition of an insurance contract**
  - The risk mitigation option—**application from the transition date and the option to apply the Fair Value Approach for restatement at transition date.**
  - The risk mitigation option—**use of reinsurance contracts held as hedging instruments**

Proposed amendments to be finalised

The risk mitigation option—use of reinsurance contracts held as hedging instruments

Feedback

- All respondents who commented on the proposal to extend the risk mitigation option to circumstances in which an entity uses reinsurance contracts held to mitigate financial risk arising from insurance contracts with DPF:

  (a) Supported the proposal

  (b) Agreed with the Board's view that the proposal would reduce accounting mismatches.

Staff analysis and recommendations

- The Staff recommended the IASB **finalise** the amendment discussed as proposed in the ED.

Deloitte Comment Letter

- Our position: *"Whilst **we do not disagree** with the IASB's proposal (…) we think a better solution is possible."*

- Our proposal: *"(…) we propose an amendment to the proposed IFRS 17:B115 to say: to the extent the entity meets the conditions in paragraph B116 and to the extent that the change in the contractual service margin is economically offset by any reinsurance contract held for the purposes described in paragraph B116, it may choose not to recognise a such change in the contractual service margin to reflect changes in the effect of financial risk on the amount of the entity's share of the underlying items or the fulfilment cash flows set out in paragraph B113(b)."*

Next steps

- During January and February 2020 meetings, the IASB will vote on the remaining topics:

  1. Scope exclusion for credit cards;
  2. CSM attributable to investment services—coverage units for insurance contracts without direct participating features, disclosures and terminology;
  3. Applicability of the risk mitigation option to non-derivative financial instruments at FVTPL;
  4. The prohibition from applying the risk mitigation option retrospectively;
  5. Effective date of IFRS 17 and extension of the IFRS 9 temporary exemption in IFRS 4;
  6. [Non-ED item] Level of aggregation—annual cohorts for some specific insurance contracts;
  7. [Non-ED item] Business combinations—contracts acquired in their settlement period;
  8. [Non-ED item] Interim financial statements;
  9. [Non-ED item] Additional specific transition modifications and reliefs (including transition requirements for IACF);

- The Staff anticipated that a paper to the IASB regarding the proposed effective date of IFRS 17 and the proposed extension of the IFRS 9 Financial Instruments temporary exemption in IFRS 4 will be tabled towards the end of redeliberations.

- The Staff noted that this timetable will allow sufficient time for the IASB to consider further the feedback on the remaining topics and to finalise any resulting amendments, in line with the IASB’s plan, in mid-2020.

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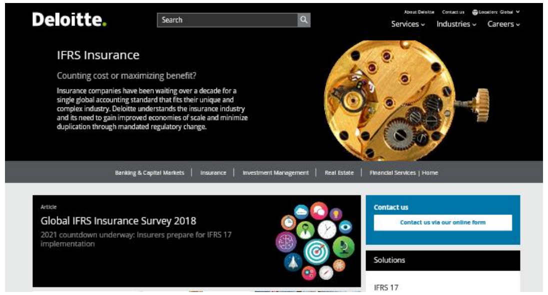

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