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IFRS in Focus
IASB proposes to amend IFRS 17 *Insurance Contracts* to assist implementation

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This IFRS in Focus addresses the proposed amendments to IFRS 17 *Insurance Contracts* set out in Exposure Draft ED/2019/4 *Amendments to IFRS 17* (the 'ED') that has been published by the International Accounting Standards Board (IASB) in June 2019.

- The ED, if finalised, will make targeted amendments to IFRS 17 to respond to concerns and challenges raised by stakeholders as IFRS 17 is being implemented.
- To allow time for implementation, the IASB proposes to amend the IFRS 17 mandatory effective date to require mandatory application for annual periods beginning on or after 1 January 2022, and as a consequence, the IASB also proposes to amend the fixed expiry date of the IFRS 9 deferral option in IFRS 4 to the same date.
- The proposed effective date for the amendments would be the same as the proposed new effective date for IFRS 17 (i.e. annual periods beginning on or after 1 January 2022).
- The IASB requests comments on the proposed amendments by 25 September 2019.

Background

Since the IASB issued IFRS 17, it has been undertaking a comprehensive programme of stakeholder engagement, including holding four meetings of the IFRS 17 Transition Resource Group (TRG). Through this process and other stakeholder engagements, the IASB has identified 25 concerns and implementation challenges, including those related to the balance of costs and benefits from applying IFRS 17. After consideration of those 25 concerns and implementation challenges, the IASB conducted a process of evaluating the need for making changes to the Standard and decided to propose 13 amendments to IFRS 17 that in the Board's view would not change the fundamental principles, would not result in the loss of user information and would not significantly disrupt implementation already underway. Those proposals are now exposed for comment.

The proposed amendments

Deferral of the date of initial application of IFRS 17 by one year

The IASB proposes to amend the mandatory effective date of IFRS 17, so that entities would be required to apply IFRS 17 for annual periods beginning on or after 1 January 2022. The IASB believed that the uncertainty about the amendments proposed in this ED could disrupt the progress of implementing IFRS 17. This uncertainty, together with the significant change in accounting that IFRS 17 creates, represents an exceptional circumstance and so justifies a delay in the effective date. The IASB decided that a deferral of one year would be sufficient to address any implementation concerns.

At the same time, the IASB proposes to amend the fixed expiry date for the temporary exemption in IFRS 4 *Insurance Contracts* from applying IFRS 9 *Financial Instruments* (see our IFRS in Focus for more detail on the temporary exemption), so that entities would be required to apply IFRS 9 for annual periods beginning on or after 1 January 2022.

For more information please see the following websites:

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Observation
If the proposed amendment to defer the effective date of IFRS 17 is finalised and the temporary exemption from applying IFRS 9 is extended at the same time, some entities would not apply IFRS 9 up to four years after other entities. That delay might result in a loss of useful information. However, without the proposed extension of the fixed expiry date for the IFRS 9 deferral option, entities would be forced to apply IFRS 9 in 2021 and this would result in changes to the classification and measurement of financial assets compared with IAS 39 *Financial Instruments*: *Recognition and Measurement*, yet entities would be able to or be required to change the classification of certain financial assets again on application of IFRS 17 in 2022, resulting in potential disruption.

Additional optional scope exclusion for loan contracts that transfer significant insurance risk

The IASB proposes to amend the scope of IFRS 17 and IFRS 9 for insurance contracts that provide insurance coverage only for the settlement of the policyholder's obligation created by the contract.

Those contracts typically combine a loan with an agreement from the entity to compensate the borrower if a specified uncertain future event adversely affects the borrower, by waiving some or all the payments due under the contract. They are often issued by a non-insurance entity and may not typically be seen as insurance contracts.

Examples of these contracts are the following:

- Mortgages with a death waiver contract
- Student loan contracts (with repayments being income contingent)
- Lifetime mortgage contracts (sometimes referred to as equity release mortgages)

The proposed amendment is to enable entities issuing such contracts to account for those contracts applying either IFRS 17 or IFRS 9.

In particular, the proposed amendment would amend the transition requirements in IFRS 9 so that an entity could apply either IFRS 17 or IFRS 9 irrespective of whether it has already applied IFRS 9 before it first applies IFRS 17. This election would be made for each portfolio of insurance contracts, and the choice for each portfolio would be irrevocable.

The IASB decided that this amendment is needed as IFRS 17 currently requires entities to account for some loans that transfer significant insurance risk as insurance contracts in their entirety.

While IFRS 4 allowed the separation of the loan component from the insurance contract, IFRS 17 prohibits this and requires separation only of distinct investment components. Because the loans are not distinct investment components, IFRS 17 applies to the entire contract. As both IFRS 9 and IFRS 17 have requirements that can address both credit risk and insurance risk (albeit with a different focus), the IASB was concerned that requiring an entity to apply IFRS 17 to those contracts would impose costs on those entities without a corresponding benefit.

Additional scope exclusion for credit card contracts that provide insurance coverage

For some credit cards, a credit card issuer provides customers with protection for purchases within a certain price range. Such protection, arising from legal terms of the contract or regulation, may transfer significant insurance risk, bringing the credit cards contracts into the scope of IFRS 17.

This proposal would amend the scope of IFRS 17 to exclude from the scope of the Standard credit card contracts that provide insurance coverage for which the entity does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer.

Without the amendment, entities that currently account for a loan or a loan commitment in a credit card applying IFRS 9 would need to change the accounting for those contracts when IFRS 17 is effective, shortly after having incurred costs to develop a new credit impairment model to comply with IFRS 9.

Observation
The scope exclusion for credit card contracts is not a choice compared with the scope exclusion for loan contracts that provide insurance coverage only for the settlement of the policyholder's obligation created by the contract. The former are required to be accounted for under IFRS 9, whereas for the latter the entity has a choice whether to apply IFRS 17 or IFRS 9.

Insurance acquisition cash flows relating to expected contract renewals
The amendment proposed in the ED would require an entity to:

a. Allocate on a systematic and rational basis part of the insurance acquisition cash flows that are directly attributable to newly issued contracts to related contract renewals;

b. Recognise those cash flows as an asset until the entity recognises groups of related contract renewals; and

c. Assess the recoverability of the asset each reporting period until the entity recognises the renewed contracts based on the expected fulfilment cash flows of the related group of insurance contracts if facts and circumstances indicated they may be impacted.

The amendments also clarify that when an entity recognises in a reporting period only some of the acquisition cash flows expected to be included in the group (i.e. when the group straddles a reporting period), the entity determines the related portion of the acquisition cash flows asset that it derecognises and includes in the fulfilment cash flows of the group.

The IASB also proposes to amend the disclosure requirements to require an entity to provide:

a. A reconciliation of the asset at the beginning and the end of the reporting period and its changes, specifically recognition of any impairment loss or reversals; and

b. Quantitative disclosure, in appropriate time bands, of the expected timing of the inclusion of these acquisition cash flows in the measurement of the related group of insurance contracts.

The proposed amendment results from a discussion at the TRG. The group discussed concerns relating to non-refundable commissions paid to agents, where the costs may be high and the entity expects to recover them only if there are future contract renewals. When future contract renewals fall outside the contract boundary of the newly issued group of insurance contracts, they are ignored in the measurement of the group, and so acquisition costs cannot be deferred and attributed to those future contracts renewals. Consequently the acquisition costs would be directly attributable to the group of issued insurance contracts, potentially making the group onerous. Some stakeholders stated that the existing requirements in IFRS 17 would result in inconsistent outcomes compared with similar contracts within the scope of IFRS 15 *Revenue from Contracts with Customers*.

The measurement approaches of IFRS 17 and IFRS 15 differ, however, the IASB have proposed to more closely align the requirements of IFRS 17 with respect to acquisition costs with those requirements in IFRS 15. The IASB believe this would provide useful information for users of financial statements and would not unduly disrupt the implementation process already under way. The Board decided not to develop specific requirements on how to allocate part of the insurance acquisition cash flows to anticipated contract renewals, considering the existing guidance in IFRS 17 as sufficient.

Contractual service margin (CSM) allocation relating to investment components
The IASB proposes to:

a. Clarify that the definition of the coverage units and coverage period for insurance contracts with direct participation features (direct participating contracts) includes the quantities of benefits and expected periods in which an entity provides investment-related services; and

b. Require an entity to allocate the CSM for insurance contracts without direct participation features based on coverage units determined considering the quantities of benefits and expected period of both insurance coverage and any investment-return service.

In addition, this amendment would amend the disclosure requirements to require an entity to provide:

a. Quantitative disclosure, in appropriate time bands, of the expected recognition in profit or loss of the CSM remaining at the end of the reporting period; and

b. Specific disclosure of the approach to assessing the relative weighting of the benefits provided by insurance coverage and investment-related services or investment-return services.

Currently, IFRS 17 allows the recognition of the CSM only over the coverage period based on coverage units, as coverage for insured events is provided. However, the IASB decided to propose an amendment to the definition of coverage for direct participating contracts to include the provision of both insurance and investment services. However, this decision on its own would create a difference in recognition of CSM for those contracts accounted for under the general model which also provide both insurance and investment services. Therefore, the IASB also proposes to amend IFRS 17 so that in the general model the CSM is allocated on the basis of coverage units that are determined by considering both insurance coverage and any investment-return service. This amendment, if finalised, would also require an update to the disclosure requirements.

The ED also proposes consequential amendments to the definitions of 'contractual service margin', 'coverage period', 'liability for remaining coverage' and 'liability for incurred claims'.

Observation
The decision whether to include investment-return service in determining the coverage units is not an accounting policy choice and the IASB proposes that entities exercise judgement and apply it consistently.

Extension of the risk mitigation option to include reinsurance contracts held
For insurance contracts with direct participating features only and in specified circumstances, IFRS 17 includes an option for an entity to recognise the effect of some changes in financial risk on the entity's share of the underlying items in profit or loss, instead of adjusting the CSM (risk mitigation option). The IASB proposes to amend IFRS 17 to permit an entity to apply the risk mitigation option for insurance contracts with direct participation features when the entity uses reinsurance contracts held to mitigate financial risks.

Currently, under IFRS 17, both reinsurance contracts held and issued are excluded from the definition of insurance contracts with direct participating features and instead are accounted for using the general model, as opposed to the variable fee approach (VFA). This means that for direct participating contracts, the effect of financial guarantees and the effect of financial risk on the entity's share of underlying items is reflected in the CSM, as opposed to profit or loss, unless the entity hedges the risk with derivatives and applies the risk mitigation option. However, for reinsurance contracts held which may transfer to the reinsurer both financial and non-financial risk, the effect of financial guarantees and the effect of financial risk is reflected in profit or loss. This creates a mismatch.

The IASB decided not to extend the scope of direct participating contracts for reinsurance contracts held when the underlying contracts are direct participating insurance contracts. Instead, to address the mismatch, the IASB proposes to expand the scope of the existing risk mitigation exception in IFRS 17 relating to the accounting for direct participating insurance contracts issued to include not only derivatives, but also reinsurance contracts held, on the grounds that it would not unduly disrupt the implementation underway.

Observation
The risk mitigation option is a choice similar to hedge accounting. To be able to apply the risk mitigation option for direct participating contracts when the entity uses reinsurance contracts held to mitigate financial risks, the entity would need to have a previously documented risk management objective and strategy and, in applying that objective, demonstrate that economic offset exists. The IASB is also proposing to clarify that the risk mitigation option cannot be discontinued, unless the eligibility criteria for the group in IFRS 17:B116 cease to apply.

Reinsurance contracts held when underlying contracts are onerous
The ED proposes an amendment to require an entity to adjust the CSM 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. The amount of the adjustment and resulting income is determined as equal to the loss recognised on the group of underlying insurance contracts multiplied by the fixed percentage of claims on the group of underlying insurance contracts the entity has a right to recover from the issuer of the reinsurance contract.

The IASB considers this solution helps to avoid an accounting mismatch, avoids significant loss of useful information and reduces complexity.

Observation

The amendment, if finalised, would eliminate a 'day one' mismatch for entities which issue insurance contracts that are onerous on initial recognition and transfer the risk using proportionate reinsurance contracts held. The IASB considered whether the proposed amendment should also apply to reinsurance contracts held that do not provide proportionate coverage. However, for those contracts, an entity would be required to make more arbitrary assumptions to identify the extent to which expected recoveries relate to a loss recognised on the underlying insurance contracts. Hence, for non-proportionate insurance contracts, the IASB concluded that it is not possible to identify the accounting mismatch described above on initial recognition and, therefore, does not propose an amendment to the initial recognition requirements.

On subsequent measurement, both proportionate and non-proportionate reinsurance contracts held reflect in profit or loss the change in fulfilment cash flows that results from the change in the loss component of the underlying insurance contracts issued.

Simplified presentation of insurance contracts in the statement of financial position

The ED proposes requiring an entity to present insurance contract assets and liabilities in the statement of financial position determined using portfolios of insurance contracts rather than groups of insurance contracts.

The IASB sees merit in providing the practical relief to present insurance contracts at a higher level of aggregation in the statement of financial position, balancing this with the requirements of the *Conceptual Framework for Financial Reporting* prohibiting offsetting. The loss of information in presentation from offsetting is deemed acceptable when considering the cost relief and the amendment would not disrupt existing implementation processes. Accordingly, the IASB proposes for presentational purposes to require entities to offset groups at the portfolio level. This would amend IFRS 17:78 so that instead of presenting separately groups that are assets and liabilities, the entity would be required to present separately portfolios of insurance contracts that are assets, portfolios of insurance contracts that are liabilities, portfolios of reinsurance contracts held that are assets and portfolios of reinsurance contracts held that are liabilities.

Observation

The unit of account for measurement is still a group, but the amendment removes the requirement to present based on that group. The reconciliations required by IFRS 17:100 to 109 to the amounts presented in the statement of financial position require disaggregation that may still require disclosure at a group level, for example, those related to loss components.

Additional transition relief for business combinations

For insurance contracts acquired in a business combination or a portfolio transfer, the liability for settlement of claims incurred before the contracts were acquired/transferred includes a risk of adverse claims development and is a liability for remaining coverage leading to recognition of revenue in the acquiring entity in future periods.

The IASB proposes to amend the transition requirements to add a specified modification to the modified retrospective approach to require an entity to classify the liability for settlement of claims incurred before the contracts were acquired/transferred as liability for incurred claims. The use of this modification is permitted only when the entity does not have reasonable and supportable information to apply a retrospective approach. The IASB also proposes an optional relief to the fair value transition approach to classify such a liability as liability for incurred claims.

The IASB is responding to preparer concerns about the difficulty of estimating the CSM on transition related to the claims development coverage for contracts acquired in business combinations and portfolio transfers, using both fair value and modified retrospective approaches.

Observation

The proposed amendment applies only on transition to IFRS 17 and therefore insurance contracts acquired after transition to IFRS 17 would include the risk of adverse claims development in the liability for remaining coverage (and thereafter as revenue).

Additional transition relief for the date of application of the risk mitigation option and the use of the fair value transition approach

The IASB considered allowing retrospective application of the risk mitigation option, but has decided to retain the prohibition in IFRS 17 of retrospective application to avoid the use of hindsight. Instead, the IASB proposes to extend the use of the fair value approach on transition to groups where the entity has the information to apply IFRS 17 retrospectively and to bring the date forward for the application of the risk mitigation option to the transition date.

The ED proposes to amend the transition requirements in IFRS 17 to permit an entity to apply the risk mitigation option prospectively from the IFRS 17 transition date, as opposed to the date of initial application, provided that the entity designates its risk mitigation relationships to apply the risk mitigation option no later than the IFRS 17 transition date. The date of initial application is the beginning of the annual reporting period in which an entity first applies IFRS 17, whereas the transition date is the beginning of the annual reporting period immediately preceding the date of initial application.

The IASB also proposes an amendment of the transition requirements in IFRS 17 to permit an entity to use the fair value transition approach for a group of insurance contracts with direct participating features if, and only if, the entity:

a. can apply IFRS 17 retrospectively to the group;

b. chooses to apply the risk mitigation option to the group prospectively from the transition date; and

c. has used derivatives or reinsurance contracts held to mitigate financial risk arising from the group before the transition date.

In proposing the amendment, the IASB has responded to stakeholder concerns about the impact of not applying the option retrospectively, while retaining the principle of not allowing the use of hindsight for hedge accounting.

Other proposed amendments

Amendment	Observation
Amendment to IFRS 17:B96(c) to exclude from the adjustment to the CSM changes between the expected and actual repayment of an investment component arising due to changes relating to the time value of money and financial risk.	The repayment of investment components is certain, with the only uncertainty relating to the timing. The proposal would reflect changes relating to time value and financial risk in insurance finance income or expense. However, changes in the amount of the repayment of investment components other than those relating to time value of money and financial risk would adjust the CSM at the locked in rate.
Amendment to IFRS 17:B96(d) when an entity chooses to disaggregate changes in the risk adjustment for non-financial risk between those relating to non-financial risk and those relating to financial risk and the effect of the time value of money.	The April 2019 TRG discussion confirmed that the choice to disaggregate changes in the risk adjustment for non-financial risk between those relating to financial and non-financial risk is optional. However, if chosen, it would affect the measurement of the CSM, the timing of recognition of changes in the financial risk and the split between revenue and insurance finance income or expense.
Amendment to clarify that an entity can discontinue the use of the risk mitigation option to a group of insurance contracts only if any of the eligibility criteria for the group in IFRS 17:B116 cease to apply.	This amendment brings the risk mitigation option requirement closer to the requirements of hedge accounting in IFRS 9.
Amendment to clarify the definition of an investment component to be repayable in all circumstances.	This amendment clarifies that 'repayable in all circumstances' includes repayable on cancellation, surrender and expiry. Some contracts include repayable to policyholders regardless of a claim occurring, but, for example, not repayable on cancellation. Such amounts would not meet the proposed clarified definition of investment components.
Amendment to ensure IFRS 17 applies to investment components that, if separated, would meet the definition of investment contracts with discretionary participation features.	This proposed amendment clarifies and overcomes the unintended consequence of excluding from the scope of IFRS 17 a distinct component representing a contract that would otherwise be within the scope of the Standard had it been issued as a standalone contract.
Amendments to IFRS 17:48(a) and IFRS 17:50(b) clarifying that the loss component is adjusted for changes in the risk adjustment for non-financial risk.	The proposed amendment clarifies that changes in fulfilment cash flows include changes in the risk adjustment for non-financial risk, as well as changes in expected future cash flows.
Amendment to clarify that changes in the measurement of a group of insurance contracts caused by changes in underlying items should, for the purposes of IFRS 17, be treated as changes in investments and hence as changes related to the time value of money or assumptions that relate to financial risk.	The proposed amendment clarifies the treatment of insurance contracts where the underlying items themselves contain non-financial risk, such as a pool of insurance contracts.

Amendment	Observation
Amendment to IFRS 17:B123(a) to clarify that changes resulting from cash flows of amounts lent to customers and waivers of amounts lent to customers are excluded from insurance revenue.	Various types of insurance contracts, including loans with a waiver on occurrence of an insured event (e.g. equity release mortgages), and reinsurance arrangements contain loans from the issuer to the policyholder. Excluding such advances and repayments of loan amounts from revenue is consistent with the treatment of investment components. A waiver of a loan would be treated as any other claim.
Amendment to IFRS 17:103 to clarify that, in the reconciliation from the opening to the closing balance of the insurance contract liabilities, an entity need not disclose refunds of premiums separately.	In proposing to clarify the definition of an investment component as repayable in all circumstances, the IASB introduces a concept of an amount that is repayable regardless of the claim occurring but not repayable on maturity of the contract, because it is consumed as the service is provided. This amount repayable before the contract expiry is a premium refund. At the point of repayment, the identification of an amount as a repayment of investment component or premium refund was seen as burdensome by preparers, as it does not impact recognition and measurement.
Amendment to IFRS 17:28 to clarify that insurance contracts are added to a group when they meet the recognition criteria, regardless of when they were issued.	The IASB confirmed that a similar amendment is not needed for IFRS 17:22 as that paragraph refers to the time at which insurance contracts are issued, rather than recognised. This has practical implications for contracts issued in one period (when there is one annual group) but relating to coverage periods starting in future periods.
Amendment to IFRS 17:104, B121 & B124 to explicitly exclude amounts relating to risk adjustment for non-financial risk from the descriptions of other components.	This amendment became necessary to prevent potential double counting.
Amendment to the disclosure requirement for sensitivity analyses to replace 'risk exposure' with 'risk variable'.	This amendment is necessary to correct the terminology used.
Amendment to IFRS 17:B93 to B95 to clarify that references to business combinations refer to business combinations within the scope of IFRS 3 *Business Combinations.*	This amendment clarifies that these measurement requirements are not necessarily applicable to business combinations under common control.
Consequential amendment to IFRS 3 for business combinations that occurred before the date of initial application of IFRS 17, to allow an entity to continue to use an exception in IFRS 3:17(b) and to classify acquired insurance contracts based on conditions existing at the inception of the contracts rather than at the acquisition date.	Significance of insurance risk can change over time. For contracts acquired in a business combination the acquirer assesses the significance of insurance risk and the resulting classification of the contract as an insurance contract at the acquisition date under IFRS 3:15. However, because IFRS 3 contained an exception to this principle for insurance contracts in the scope of IFRS 4, this practical expedient allows entities to keep existing insurance contract classifications for business combinations occurring before the date of initial application of IFRS 17.
Consequential amendment to the scope of IFRS 7 *Financial Instruments: Disclosures*, IFRS 9 and IAS 32 *Financial Instruments: Presentation* to exclude from the scope of those standards insurance contracts as defined in IFRS 17 and investment contracts with discretionary participation features in the scope for IFRS 17, instead of excluding contracts within the scope of IFRS 17.	The amendment overcomes the unintended consequence of including in the scope of those Standards insurance contracts held.

Transitional provisions, effective date and comment period

The IASB proposes that an entity applies the amendments to IFRS 17 for annual periods beginning on or after 1 January 2022, with early application permitted. This coincides with the new proposed effective date of IFRS 17. The amendments would be applied retrospectively.

The IASB requests comments on the ED by 25 September 2019.

Further information

If you have any questions about the amendments to IFRS 17, please speak to your usual Deloitte contact or get in touch with a contact identified in this *IFRS in Focus*.

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