# Amendments to IFRS 17 from March 2019 IASB Meeting

March 2019

## INTRODUCTION

Since the publication of IFRS 17 (**the Standard**) in May 2017, the insurance industry has been focused on implementation in advance of the original effective date of 1 January 2021. A number of issues, both practical and technical in nature, have been identified by industry through the implementation period. These issues have been brought to the attention of the IASB through the Transition Resource Group, and also through industry bodies and groups such as the CFO Forum. This resulted in the IASB proposing to postpone the effective date by a year to 1 January 2022 to give industry further time to prepare. Since December the IASB has also been considering amendments to the Standard to address some of the concerns raised.

At its March meeting the IASB has considered amendments to the Standard in the following areas:

- Level of aggregation;
- Scope of IFRS 17 to certain credit card contracts;
- Transition requirements in respect of the previously agreed tentative changes to the application of the risk mitigation option and loans that transfer significant insurance risk; and
- Implications for disclosure and transition requirements, and further amendments required, as a result of the recent proposed amendments to IFRS 17.

This paper provides an overview of the areas discussed and the outcomes of the discussions of the March meeting. Detail on the discussions at the January and February IASB meetings on IFRS 17 can be found in our briefing notes here.

## 1) LEVEL OF AGGREGATION OF INSURANCE CONTRACTS[1]

IFRS 17 requires an entity to recognise and measure groups of insurance contracts.

Groups are determined by identifying portfolios of insurance contracts, where a portfolio comprises contracts subject to similar risks and managed together. Portfolios are then divided into a minimum of three groups (**profitability buckets**) as follows:

- contracts that are onerous at initial recognition;
- contracts that at initial recognition have no significant possibility of becoming onerous subsequently; and
- remaining contracts in the portfolio.

Finally, it is necessary to divide these profitability buckets into groups of contracts not issued more than 12 months apart (**annual cohorts**).

The IASB Staff reported that some stakeholders expressed concerns with the resulting level of (dis)aggregation specified by IFRS 17, mainly relating to the annual cohort requirement. The key concerns raised included:

- the requirements will not provide users of financial statements with useful information;
- implementing the requirements is a major challenge and the benefits do not outweigh the costs; and
- the requirements are unnecessary because an entity can achieve the same outcome without applying those requirements.

The IASB Staff noted that providing information about timely recognition of losses on onerous contracts, profits on profitable contracts and trends in an entity's profitability from contracts over time are key benefits of IFRS 17.

The IASB Staff recognises that implementing IFRS 17 involves significant costs but believes that the requirements on the level of aggregation in IFRS 17 are essential to providing useful information, particularly regarding trends in profitability over time. They also noted that at its December 2018 meeting the IASB tentatively agreed to a higher level of aggregation for presentational (but not calculation) purposes.

The IASB Staff recommended the IASB retains the IFRS 17 requirements on the level of aggregation unchanged.

The IASB agreed with the Staff's recommendation and tentatively voted to retain the current requirements.

## 2) CREDIT CARD CONTRACTS THAT TRANSFER SIGNIFICANT INSURANCE RISK[2]

The IASB considered whether IFRS 17 should apply to certain credit card contracts. In summary, the example considered by the IASB Staff was a retail credit card facility subject to standard terms such as a customer credit limit, minimum monthly

[1] Agenda items 2A, 'Level of aggregation – Stakeholder concerns, implementation challenges and staff analysis', 2B 'Level of aggregation – IFRS 17 requirements and Board's rationale' and 2C 'Level of aggregation – History of the Board's decisions and stakeholder feedback' prepared for the meeting of the IASB scheduled for March 2019.

[2] "Credit cards that provide insurance coverage", Agenda item 2D prepared for the meeting of the IASB scheduled for March 2019.

repayments and interest charged at a stated rate unless the balance is paid off in full by a specified date. The insurance coverage arises from an undertaking by the card issuer to refund the customer for certain claims against a supplier e.g. purchased goods are not delivered or are defective.

It is assumed that the card issuer either does not charge an *explicit* fee to the customer, or that any annual fee charged does not reflect an assessment of the insurance risk associated with an individual customer (e.g. his/her propensity to make purchases on fly-by-night websites).

IFRS 4 currently permits the separation of the loan component from an insurance contract and the application of IFRS 9 to the loan component. However, the loan component and the insurance component (which must involve significant risk transfer for IFRS 17 to apply) cannot be accounted for separately under IFRS 17.

Broadly similar issues for certain loan-based contracts involving the transfer of significant insurance risk (such as lifetime / equity release mortgages) were considered at the IASB's February 2019 meeting.[3] The IASB tentatively agreed at that meeting that issuers should be permitted to apply either IFRS 9 or IFRS 17 to a portfolio of insurance contracts that provide insurance coverage only for the settlement of the policyholder's obligation created by the contract. However, this conclusion does not cover retail credit card facilities that transfer significant insurance risk, as these provide coverage for the settlement of the supplier's obligation, rather than the customer's obligation.

The IASB Staff's view is that the existing accounting for credit card contracts provides useful information about the components of those contracts, and IFRS 17 would introduce changes to that accounting which might impose costs and disruption[4] for no significant benefits.

The IASB Staff considered three possible approaches to excluding those credit card contracts providing significant insurance coverage from the scope of IFRS 17:

- extending the existing scope exclusion in paragraph 7a of the Standard relating to warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer. (IFRS 15 *Revenue from Contracts with Customers* will continue to apply to such warranties); or
- extending the existing choice in paragraph 8 of the Standard between IFRS 15 and IFRS 17 for certain fixed-fee service contracts; or
- explicitly amending the Standard to exclude such contracts from its scope.

The IASB Staff recommended the third approach.

However, the wording of the proposed exclusion appears rather narrower in some respects than the example considered in the Paper. It refers to those "*credit card contracts that provide insurance coverage for which the issuer* <u>*does not reflect an assessment of the insurance risk associated with an individual customer in setting the price of the contract with that customer*</u>". In contrast, the example considered by the IASB Staff considered whether an *explicit* fee is levied on the customer. In practice an implicit fee may be levied through the setting of the interest rate that applies to balances that are not paid off by the specified date. This point was not specifically discussed at the IASB meeting.

The IASB agreed with the Staff's recommendation and tentatively voted to amend the Standard to explicitly exclude such contracts from its scope.

## 3) TRANSITION – THE RISK MITIGATION OPTION[5]

The Contractual Service Margin (**CSM**) for insurance contracts with direct participation features must be adjusted *inter alia* for (i) the effect of the entity's share of the underlying items and (ii) financial risks other than those arising from the underlying items, for example the effect of financial guarantees.[6]

Where entities purchase derivatives to mitigate the risks of changes in financial assumptions, an accounting mismatch can arise because:

- the change in the fair value of the derivative is recognised in profit or loss under IFRS 9; but
- the change in the direct participation insurance contract due to the risk that was mitigated by the derivative would be adjusted through the CSM under IFRS 17, unless the contracts are onerous.

There is a **risk mitigation option** in IFRS 17 for an entity, under certain circumstances, to recognise the effect of some changes in financial risk on direct participation insurance contracts in profit or loss, instead of adjusting the CSM.

Some stakeholders raised concerns that this risk mitigation option can only be used prospectively from the date of initial application of IFRS 17, even though risk mitigation activities may have been in place before that date. In particular, as the CSM on transition will be allocated to profit and loss in the future, any risk mitigation activities from prior periods that are not reflected in the CSM may distort:

[3] They were also considered at the March 2019 meeting – see Section 4 below.
[4] We assume "disruption" is a reference to different treatment for those credit card contracts which transfer significant insurance risk and those that do not.

[5] "Transition requirements – Risk mitigation option", Agenda item 2E prepared for the meeting of the IASB scheduled for March 2019.
[6] These two adjustments are not made to the CSM for insurance contracts to which the Variable Fee Approach (**VFA**) does not apply.

- the equity of an entity on transition, as the effect of previous changes in the fair value of the derivatives will be included in equity but the corresponding effect on the insurance contracts will be included in the measurement of the insurance contracts; and
- the revenue recognised in future periods will include changes in financial risks that would have been excluded if the risk mitigation option could be applied retrospectively.

At the February 2019 meeting, the IASB tentatively decided to retain the prohibition of the retrospective application of the risk mitigation option. The IASB observed that it is hard to see how the option could be applied retrospectively without the use of hindsight, and without the risk of 'cherry picking' opportunities.

However, the IASB was sympathetic to the concerns raised by stakeholders, and asked the IASB Staff to continue to explore alternative proposals that would address the issues arising from not allowing application of the option retrospectively.

The IASB Staff recommended:

a) permitting a prospective application of the risk mitigation option from the **transition date**[7], provided that the entity designates the relevant risk mitigation relationships no later than on that date; and

b) permitting entities that have used derivatives or reinsurance contracts to mitigate financial risk arising from direct participation insurance contracts before the transition date to apply the fair value approach to transition, even if they are able to apply the Full Retrospective Approach to such contracts.

Recommendation a) will eliminate accounting mismatches in the comparative periods presented and in the current period. It will not eliminate mismatches arising from not reflecting risk mitigation activities before the transition date.

Recommendation b) would permit the CSM on the transition date for direct participation insurance contracts to be determined considering the amount the entity would pay at that date to exit the contracts. So the value of financial guarantees would be based on market interest rates on the transition date. The CSM on the transition date would also only reflect financial risk on that date. This would be consistent with valuing a derivative held in respect of the contracts at fair value under IFRS 9.

The IASB Staff observes that recommendation b) may decrease comparability between entities on transition.

The IASB agreed with both of the Staff's recommendations, i.e. a) and b), and tentatively voted to approve these amendments.

## 4) TRANSITION - LOANS THAT TRANSFER SIGNIFICANT INSURANCE RISK[8]

Certain loan-based contracts for which the only insurance in the contract is the settlement of some or all of the obligations created by the contract would fall under the scope of IFRS 17 where they involve a transfer of significant insurance risk. Some examples of these contracts are:

- Mortgages where the outstanding loan balance is waived upon death;
- Student loans where repayment is contingent on earnings above a threshold and repayment of the loan balance is waived upon death; and
- Lifetime mortgage contracts (often referred to as "equity release mortgages") which include insurance in the form of a no-negative equity guarantee[9].

Concern was raised that applying IFRS 17 to such contracts may result in issuers, who are not writing other insurance contracts and thus not preparing for IFRS 17 for other reasons, facing significant implementation costs. Furthermore, some stakeholders suggested that applying IFRS 9 to such loans would be more appropriate, as this would be consistent with the measurement of standard loan contracts (i.e. those without insurance components) by some entities.

At the February 2019 meeting, the IASB tentatively decided to amend the scope of IFRS 17 and IFRS 9 for contracts that provide significant insurance risk transfer but only in respect of the borrower's obligations created by the contract. The proposed amendments would enable entities issuing such contracts to apply either IFRS 17 or IFRS 9, where a choice is made at a portfolio-by-portfolio level, using the definition of 'portfolio' in IFRS 17.

The IASB Staff has considered the transition requirements needed as a result of this decision. It recommended:

1. The transition requirements in IFRS 17 for loans that transfer significant insurance risk are ***unchanged*** where the entity chooses to apply IFRS 17 to a portfolio of such loans.

2. The transition requirements in IFRS 9 for loans that transfer significant insurance risk are ***unchanged*** if (i) an entity chooses

[7] This is the beginning of the annual reporting period immediately preceding the date of the initial application of IFRS 17. If an entity presents adjusted comparatives for an earlier period then it is the beginning of the earlier adjusted comparable period.
[8] "Transition requirements – Loans that transfer significant insurance risk", Agenda item 2F prepared for the meeting of the IASB scheduled for March 2019.

[9] On the death of the borrower the lender receives the lower of (i) the outstanding amount of the loan including accrued interest and (ii) the value of the property on which the loan is secured. Any excess of (i) over (ii) is waived.

to apply IFRS 9 to a portfolio of such loans and (ii) initially applies IFRS 17 and IFRS 9 at the same time.

3. The transition requirements in IFRS 9 are ***amended*** for loans that transfer significant insurance risk where an entity (i) chooses to apply IFRS 9 to a portfolio of such loans and (ii) applied IFRS 9 before it applies IFRS 17.

The recommended changes to the transition requirements in IFRS 9 referred to in bullet point 3 above essentially extend the existing arrangements for financial assets to which IFRS 9 has been applied before IFRS 17 has been applied.

In summary, when IFRS 17 is applied:

- the relevant transition requirements in paragraph 7.2 of IFRS 9 to be applied are to be determined by the entity, rather than mandated by the IASB;
- an entity may designate a financial liability as measured at fair value through profit or loss (**FVPL**) if this would eliminate, or significantly reduce, an accounting mismatch that would otherwise arise from the application of IFRS 17;
- an entity must revoke a previous designation of a financial liability as measured at FVPL if the accounting mismatch that gave rise to that designation will not apply with IFRS 17;
- an entity is not required to restate prior periods. It may only do so if (i) this is possible without the use of hindsight and (ii) the restatement reflects all of the requirements in IFRS 9 for all of the affected financial instruments;
- an entity is not required to present the quantitative information required by paragraph 28(f) of IAS 8 (or some similar information) when it revisits aspects of IFRS 9; and
- in respect of amendments made, in addition to any disclosures required by other IFRS Standards, an entity must disclose:
  - the previous classification, including measurement category where applicable, and carrying amount of the relevant loans;
  - the new classification and carrying amount of the loans;
  - the carrying amount at the date of the amendment of any financial liabilities that were previously designated as measured at FVPL; and
  - the reasons for any designation or revocation of financial liabilities as measured at FVPL.

The IASB agreed with the Staff's recommendations. and tentatively voted to:

- Retain the current transition requirements in:
  - IFRS 17 for loans that transfer significant insurance risk where the entity chooses to apply IFRS 17 to a portfolio of such loans; and
  - IFRS 9 for loans that transfer significant insurance risk if (i) an entity chooses to apply IFRS 9 to a portfolio of such loans and (ii) initially applies IFRS 17 and IFRS 9 at the same time.
- Amend the transition requirements in IFRS 9 for loans that transfer significant insurance risk where an entity (i) chooses to apply IFRS 9 to a portfolio of such loans and (ii) applied IFRS 9 before it applies IFRS 17.

## 5) AMENDMENTS TO DISCLOSURE REQUIREMENTS[10]

### CSM RECOGNITION THROUGH PROVISION OF INSURANCE COVERAGE AND INVESTMENT-RELATED SERVICES OR INVESTMENT RETURN SERVICES

In June 2018, the IASB proposed to amend IFRS 17 to clarify that the definition of the coverage period for insurance contracts with direct participation features includes periods in which the entity provides **investment-related services**.

In January 2019, the IASB proposed to amend IFRS 17:

- so that under the General Model, the CSM is recognised in P&L on the basis of coverage units that are determined by considering both insurance coverage and **investment return services**, if any;
- to require an entity to use judgement, applied consistently, in deciding whether an investment return service exists when determining coverage units; and
- to require assessments of the relative weighting of the benefits provided by insurance coverage and investment return services, and their pattern of delivery, to be made on a systematic and rational basis.

The IASB Staff notes that including these services in the determination of profit makes that determination more subjective and complex and therefore the pattern of profit recognition between different products and entities may vary significantly. Therefore the IASB Staff has recommended that specific disclosures are required to ensure clarity for users of the financial statements.

The proposed additional disclosures are:

- disclosure of quantitative information about the expected recognition of the CSM in P&L in future periods i.e. removing the option of providing qualitative information; and
- disclosure of the approach used to assess the relative weightings of the benefits provided by insurance coverage

[10] "Amendments to disclosure requirements resulting from the Board's tentative decisions to date", Agenda item 2G prepared for the meeting of the IASB scheduled for March 2019.

and investment-related services for contracts subject to the VFA, and provided by insurance coverage and investment return services for contracts subject to the General Model.

The IASB agreed with the Staff's recommendations and tentatively voted to approve these amendments to the disclosure requirements.

### INSURANCE ACQUISITION CASH FLOWS FOR RENEWALS OUTSIDE OF THE CONTRACT BOUNDARY

In January 2019, the IASB proposed to amend IFRS 17 to allow deferral of insurance acquisition cash flows in relation to insurance contracts in groups yet to be issued. These acquisition expenses would then be allocated to relevant contract renewals originally outside of the contract boundary. Recoverability of the resulting deferred acquisition cost asset would be assessed each period before the related contracts are recognised and an amount recognised in P&L for any unrecoverable amounts, or any reversal of some or all of any such loss previously recognised when the impairment conditions no longer exist or have improved.

As this introduces the potential for longer deferral periods, the IASB Staff considers that quantitative information about such insurance acquisition cash flows will be more important to users of the financial statements after these proposed amendments. Therefore the IASB Staff has recommended to require:

- reconciliation of the acquisition cash flow asset at the beginning and end of the period, specifically recognition of any impairment loss or reversals. This reconciliation should be consistent with the aggregation the entity uses for the reconciliations for the related insurance contracts required when applying paragraph 98 of the Standard; and
- quantitative disclosure of when the entity expects to include the insurance acquisition cash flows as part of the initial measurement on recognition of a group of contracts.

The IASB agreed with the Staff's recommendations and tentatively voted to approve these amendments to the disclosure requirements.

## 6) IMPLICATIONS FOR DISCLOSURE AND TRANSITION REQUIREMENTS[11]

Part 1 of the paper includes a table which shows the Staff analysis and recommendation for each of the amendments the IASB has proposed to date. In summary:

| Topic | Proposed recommendation for Disclosures | Proposed recommendation for Transition |
|---|---|---|
| 1. Scope of IFRS 17 | No action, other than as per Agenda Paper 2F about disclosures at transition (see Section 4 of this note). | Refer to recommendation in Agenda paper 2F (see Section 4 of this note). |
| 2. Insurance acquisition cash flows for renewals outside the contract boundary | Refer to recommendation in Agenda Paper 2G (see Section 5 of this note). | No action. |
| 3. CSM: coverage units in the General Model | Refer to recommendation in Agenda paper 2G (see Section 5 of this note). | No action. |
| 4. CSM: coverage units in the VFA | Refer to recommendation in Agenda paper 2G (see Section 5 of this note). | No action. |
| 5. Risk mitigation exception | No action. | Refer to recommendation in Agenda paper 2E (see Section 3 of this note). |
| 6. Reinsurance contracts held: onerous underlying insurance contracts | No action. | No action. |

[11] "Implications for disclosure and transition requirements", Agenda item 2H prepared for the meeting of the IASB scheduled for March 2019.

| Topic | Proposed recommendation for Disclosures | Proposed recommendation for Transition |
|---|---|---|
| 7. Presentation of insurance contracts in the statement of financial position | An amendment to paragraph 99 of IFRS 17 so that reconciliations are disaggregated into totals for portfolios of contracts that are assets and liabilities (rather than into totals for groups of contracts). | No action. |
| 8. Date of initial application of IFRS 17 | No action. | No action. |
| 9. Temporary exemption from applying IFRS 9 | No action. | No action. |
| 10. Transition | No action. | Not applicable |

Part 2 of the paper lists the minor amendments that the IASB proposed in June 2018 as part of the annual improvements to IFRS Standards process. The IASB Staff notes that these are limited to changes that either clarify the wording in IFRS 17 or correct relatively minor unintended consequences and as such no implications for disclosure and transition requirements have been identified.

The IASB tentatively voted to retain the current disclosure and transition requirements in IFRS 17, except as described in the tentative decisions in Sections 3, 4 and 5 above.

# SUMMARY

In summary, at its March 2019 meeting, the IASB tentatively voted to approve the following:

- Retain the IFRS 17 requirements on the level of aggregation.
- Amend IFRS 17 to explicitly exclude from its scope credit card contracts that provide significant 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.
- Amend IFRS 17 to permit a prospective application of the risk mitigation option to insurance contracts with direct participation features from the transition date, provided that the entity designates the relevant risk mitigation relationships no later than on that date.
- Amend IFRS 17 to permit entities that have used derivatives or reinsurance contracts to mitigate financial risk arising from direct participation insurance contracts before the transition date to apply the fair value approach to transition, even if they are able to apply the Full Retrospective Approach to such contracts.
- Retain the transition requirements in IFRS 17 for loans that transfer significant insurance risk where the entity chooses to apply IFRS 17 to a portfolio of such loans.
- Retain the transition requirements in IFRS 9 for loans that transfer significant insurance risk if (i) an entity chooses to apply IFRS 9 to a portfolio of such loans and (ii) initially applies IFRS 17 and IFRS 9 at the same time.
- Amend the transition requirements in IFRS 9 for loans that transfer significant insurance risk where an entity (i) chooses to apply IFRS 9 to a portfolio of such loans and (ii) applied IFRS 9 before it applies IFRS 17.
- Amend IFRS 17 disclosure requirements to require:
  - disclosure of quantitative information about the expected recognition of the CSM in P&L in future periods i.e. removing the option of providing qualitative information;
  - disclosure of the approach used to assess the relative weightings of the benefits provided by insurance coverage and investment-related services or investment return services;
  - reconciliation of the acquisition cash flow asset at the beginning and end of the period, specifically recognition of any impairment loss or reversals. This reconciliation should be consistent with the aggregation the entity uses for the reconciliations for the related insurance contracts required when applying paragraph 98 of the Standard; and
  - quantitative disclosure of when the entity expects to include the insurance acquisition cash flows as part of the initial measurement on recognition of a group of contracts.

All of these changes will be subject to due process, which will involve a public consultation.

## FURTHER READING

Milliman IFRS 17 update: January 2019 IASB meeting

Milliman IFRS 17 update: February 2019 IASB meeting

The full Staff papers for the March 2019 IASB meeting

## HOW CAN MILLIMAN HELP

Milliman has a wide range of experience in global insurance markets and, in particular, in Solvency II and IFRS 17. Milliman's experts have, and continue to, closely follow the development and implementation of both regimes.

Milliman can provide a range of services to assist with all aspects of IFRS 17, including:

- Methodology development and implementation;
- Independent review;
- Training;
- Gap analysis and impact assessment;
- Financial modelling
- Implementation of an IFRS 17 systems solution through our award-winning Integrate platform which can be implemented with cashflow output from any actuarial system. For more information see: IFRS 17: The Integrate Solution.

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