4th Capacity building seminar on IFRS 17
Mumbai
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New amendments to IFRS 17 as part of Exposure Draft

ED/2019/4

Institute of Actuaries of India

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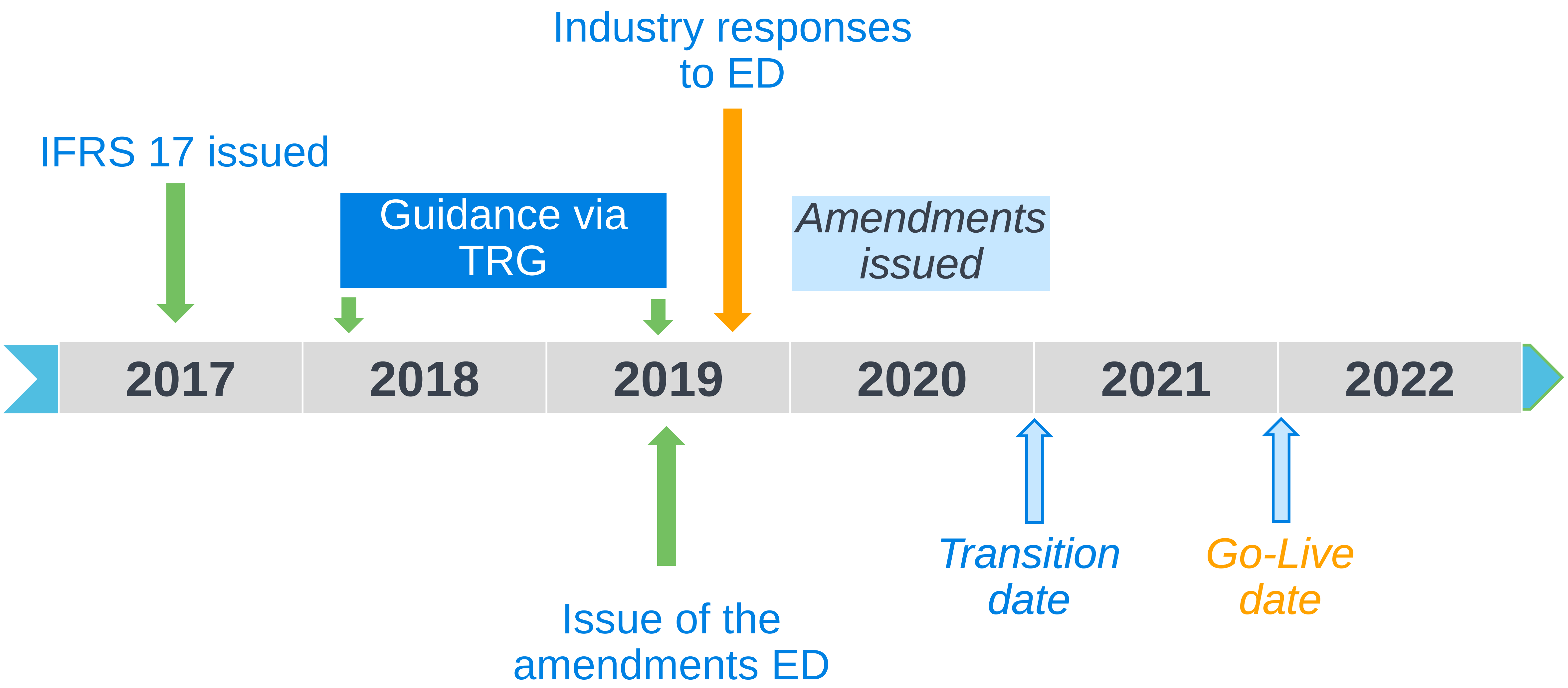
Where have we got to?

Recent developments in IFRS 17



EFRAG and the European Union

EU endorsement a critical step

EFRAG
European Financial Reporting Advisory Group

THE EU ENDORSEMENT STATUS REPORT

16 OCTOBER 2019

IASB/IFRIC documents not yet endorsed [Revisions to this schedule are marked in bold]	EFRAG draft endorsement advice	EFRAG endorsement advice	ARC Vote	When might endorsement be expected	IASB Effective date	Expected to be endorsed before the effective date
IFRS STANDARDS[1] AND INTERPRETATIONS						
IFRS 17 Insurance Contracts (issued on 18 May 2017)					01/01/2021	
AMENDMENTS						
Amendments to References to the Conceptual Framework in IFRS Standards (issued on 29 March 2018)	✓ 06/07/2018	✓ 12/10/2018	✓ 01/08/2019	× Q4 2019	01/01/2020	▲
Amendment to IFRS 3 Business Combinations (issued on 22 October 2018)	✓ 14/01/2019	✓ 28/03/2019	✓ 06/09/2019	× Q4 2019	01/01/2020	▲
Amendments to IAS 1 and IAS 8: Definition of Material (issued on 31 October 2018)	✓ 12/12/2018	✓ 20/02/2019	✓ 01/08/2019	×Q4 2019	01/01/2020	▲
Interest Rate Benchmark Reform (Amendments to IFRS 9, IAS 39 and IFRS 7) (issued on 26 September 2019)	✓ 30/09/2019	**✓ 16/10/2019**	×Q4 2019	×Q4 2019	01/01/2020	▲

Nature of the amendments

High impact	Allocation of acquisition costs to renewals
	Reinsurance accounting mismatches
	Coverage units under the GMM
Less impact	Level of aggregation for insurance contract assets and liabilities
	Risk mitigation option for VFA
	Transition relief
	Scope exclusions
Other key areas of debate	Go-Live date
	Annual cohort requirement

High Impact: Allocation of acquisition costs to renewals

What happens currently

Cash flows	Year 1 (initial contract)	Year 2 (expected renewal)	Year 3 (expected renewal)
Premium	100	100	100
Claim	-	-	-
Commission	-150	-	-
Expected loss / unearned profit	**-50**	**100**	**100**

- The commission of 150 is non-refundable. Entity expects to recover this initial commission through future renewals of the contract.
- Cash flows related to renewals are outside the boundary of the original contract.
- IFRS 17 currently requires such a commission to be attributed fully to the initial contract causing it be loss making (onerous).

High Impact: Allocation of acquisition costs to renewals

Proposed amendment

Identify **directly attributable** insurance acquisition cash flows for a group

Allocate the above expenses to that group and future groups that are expected to arise from renewals

Insurance acquisition cash flows expected to pay after the recognition of group to be as part of FCF.

Insurance acquisition cash flows paid before the group is recognized as an asset.

- **Derecognize the asset** when the insurance acquisition cash flows are allocated to the group are included in the measurement of the group.
- If only some of the insurance contracts are recognized, entity shall determine a **related portion of asset to be derecognized**

- **Disclose reconciliation** from opening to closing asset held
- Quantitative info on when the entity expects to derecognize the asset

Assess recoverability of asset at the end of recovery **period if facts and circumstances** indicate the asset may be impaired.

High Impact: Allocation of acquisition costs to renewals

Proposed amendment

Cash flows	Year 1 (initial contract)	Year 2 (expected renewal)	Year 3 (expected renewal)
Premium	100	100	100
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Expected loss / unearned profit	**-50**	**100**	**100**

Cash flows	Year 1 (initial contract)	Year 2 (expected renewal)	Year 3 (expected renewal)
Premium	100	100	100
Claim	-	-	-
Commission	-50	-50	-50
Expected loss / unearned profit	**50**	**50**	**50**
Asset for acquisition costs	**100**		

High Impact: Allocation of acquisition costs to renewals

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Concerns / Clarifications sought

- 28A reads: *‘An entity applying the premium allocation approach may recognize insurance acquisition cash flows as expenses applying paragraph 59(a). Otherwise, the entity shall allocate insurance acquisition cash flows to a group of insurance contracts on a systematic and rational basis applying paragraph B35A.’*
  - This new amendment applicable to all models or only PAA?

- Some complexities introduced for entities for whom acquisition costs are less significant and not eligible for 59 (a).

- Exposure Draft is silent on whether when making asset recoverability assessment, entity should accrete interest or not. BC41 indicates that Board chose not to prescribe anything on this to consistent with IFRS 15.

- Clarification on how amount deferred would be determined. If entity ends up writing more / less insurance contracts or / and changes in projection of future renewals.

High Impact: Reinsurance accounting mismatches

Reducing onerousness for contracts which are profit supported by reinsurance

What happens currently

- Entity to account for a reinsurance contract held separately from any underlying insurance contracts.
- For insurance contracts that are expected to be loss making, recognize losses immediately.
- Net cost / gain on reinsurance contracts to be recognized over time.

Insurance Contract Issued	
Premium	100
Claims	-150
Expected loss recognised immediately	-50
Proportionate reinsurance contracts held	
Reinsurance Premiums	-125
Claims recovered from reinsurance	120
Net cost recognised over time	-5

Assuming 80% recovery from reinsurance

High Impact: Reinsurance accounting mismatches

Reducing onerousness for contracts which are profit supported by reinsurance

Proposed amendment

Company that recognizes losses on loss making insurance contracts on initial recognition would at the same time also recognize a gain on reinsurance contracts held to the extent reinsurance contracts held:

- Cover claims of insurance contracts on a proportionate basis
- Are entered into before or at the same time loss making insurance contracts are issued

Insurance Contract Issued	
Premium	100
Claims	-150
Expected loss recognised immediately	-50
Proportionate reinsurance contracts held	
Reinsurance Premiums	-125
Claims recovered from reinsurance	120
Net cost recognised over time	-5
of which:	
- *gain recognised immediately*	*40*
- *adjusted net cost recognised over time*	*-45*

40 = 80% x Expected loss on underlying insurance contract

From B119D

High Impact: Reinsurance accounting mismatches

Concerns / Clarifications sought

Why only proportionate reinsurance?

- BC80 – Reinsurance contracts held that do not provide a proportionate coverage, although it is possible to identify the loss as being caused by claims, <u>but those claims do not have a known recovery</u>
- BC81 – Timing mismatch between the recognition of claims on insurance contracts and the recognition of recoveries could be <u>directly identified for reinsurance contracts that provide proportionate coverage</u>

High Impact: Reinsurance accounting mismatches

Concerns / Clarifications sought

Definition of **Reinsurance contracts held that provides proportionate coverage**:

‘A reinsurance contract held that provides an entity with the right to recover from the issuer a percentage of all claims incurred on groups of underlying insurance contracts. The percentage the entity has a right to recover is fixed for all contracts in a single group of underlying insurance contracts, but can vary between groups of underlying insurance contracts.

Concerns with the definition:

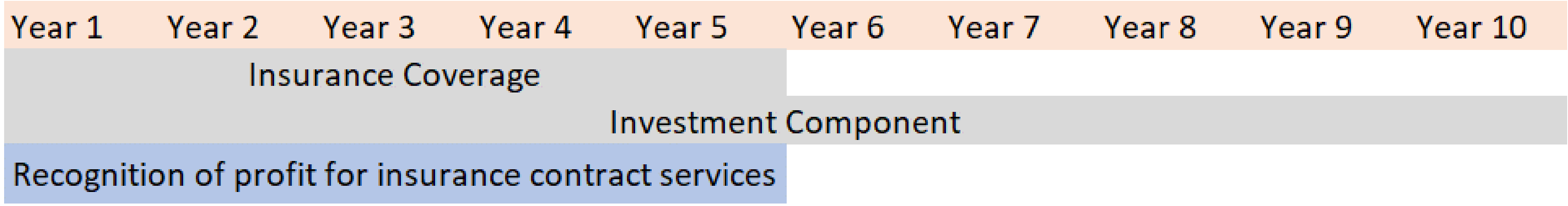
- Doesn’t cover where multiple proportionate reinsurance contracts cover different contracts in a group of underlying insurance contracts in different proportions
- Doesn’t cover reinsurance contracts that do not cover the whole group of insurance contracts
- Doesn’t cover reinsurance contracts that cover a fixed percentage of claims within a certain range (subject to deductibles or min/max limits)

High Impact: Coverage units under the GMM

Recognising investment services delivered under the general measurement model

What happens currently

- For insurance contracts without direct participation features, CSM is recognized in the P&L as insurance coverage is provided over time.



- Deferred Annuity Contracts – Insurance coverage starts only during the annuity period
- Universal Life contracts where sum at risk becomes zero after a few years – Insurance coverage ceases before

Concern is:

- Many contracts combine insurance coverage and service relating to investment activities and
- Timing of provision of service relating to investment activities might differ from the timing of insurance coverage

High Impact: Coverage units under the GMM

Proposed Amendments

(1) New terminology introduced in Appendix A - **Insurance Contract services**

The following services that an entity provides to a policyholder of an insurance contract:

(a) Coverage for an insured event (insurance coverage)

(b) For insurance contracts without direct participation features, the generation of an investment return for the policyholder, if applicable (investment-return service); and

(c) For insurance contracts with direct participation features, the management of underlying items on behalf of the policyholder (investment-related service)

(2) Conditions for without DPF to provide investment-return services in B119B

Insurance contracts without direct participation features may provide an investment-return service if and only if:

(a) An investment component exist, or the policyholder has the right to withdraw an amount

(b) The entity expects the investment component or amount the policyholder has a right to withdraw to include a positive investment return (a positive investment return could be below zero, for example, in a negative interest rate environment)

(c) The entity expects to perform investment activity to generate that positive investment return

(3) 117(c)(v) - To disclose the relative weightings of the benefits provided by insurance coverage and investment-return / investment-related service

High Impact: Coverage units under the GMM

Recognising investment services delivered under the general measurement model

Key implications

Quantitative disclosures on CSM run off in time bands; earlier only qualitative

Subjectivity in relative weightings between investment-return/ investment-related service and insurance coverage

Period of investment-return / investment-related services ends by the date all amounts due to current policyholders are paid without considering payment to future policyholders

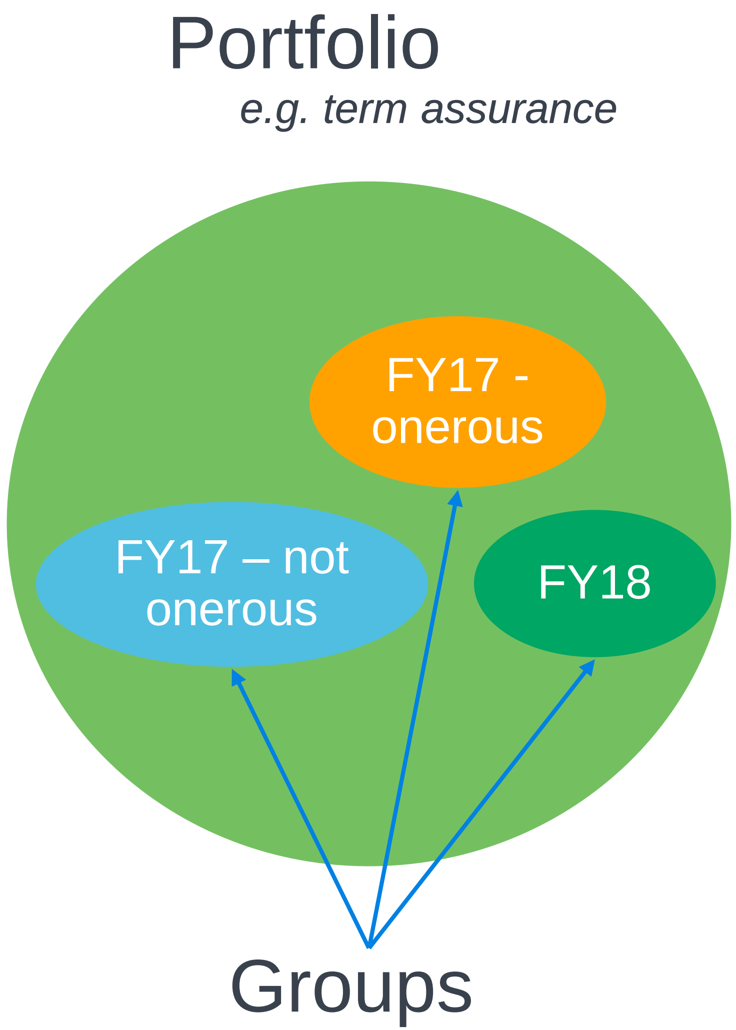
What is *'right to withdraw'* – BC58 includes surrender, refund on cancellation, transfer to another insurer

Products having investment services even though they do not have an investment component or right to withdraw

Investment-return services after an investment-related service has ended

Level of aggregation for liabilities

Insurance contract assets and liabilities need to be segregated at a portfolio level

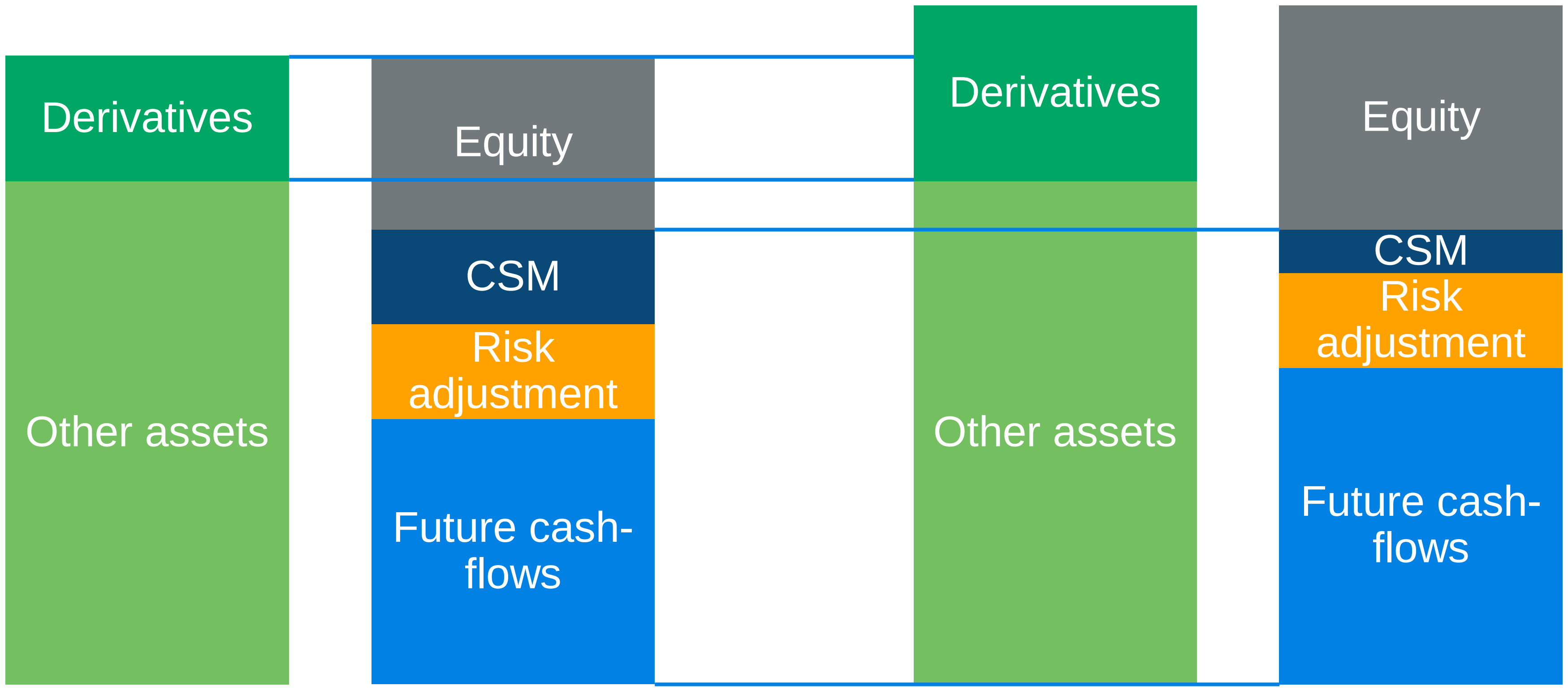


- Previously needed to report the total of all groups of insurance contracts that are in an 'asset' position (same for liabilities)
- Now only need to report portfolios that are in a net asset position
- Could have been very operationally challenging for general insurers

- Other changes in the level of granularity at which calculations need to be made.

Risk mitigation option under the variable fee approach

Without risk mitigation option, hedging can produce volatile balance sheets and P&L



Extension of the risk mitigation option

Extending the option to pass certain changes in financial risk on underlying items to P&L

- Extension of the risk mitigation option to reinsurance used to mitigate financial risk
- Still need a documented risk management policy

Transition relief

- Allowed to apply risk mitigation to periods after the transition date
- Elect to use fair value approaches if risk mitigation applied

EFRAG feedback: Should the risk mitigation option be extended further? Could it be applied retrospectively?

Scope exclusions

Certain contracts that could have been in scope of IFRS 17 have been excluded

ED proposes that an entity would be required to exclude from the scope of IFRS **17 credit card contracts** that meet the definition of an insurance contract if, and only **if, 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.

Other modifications

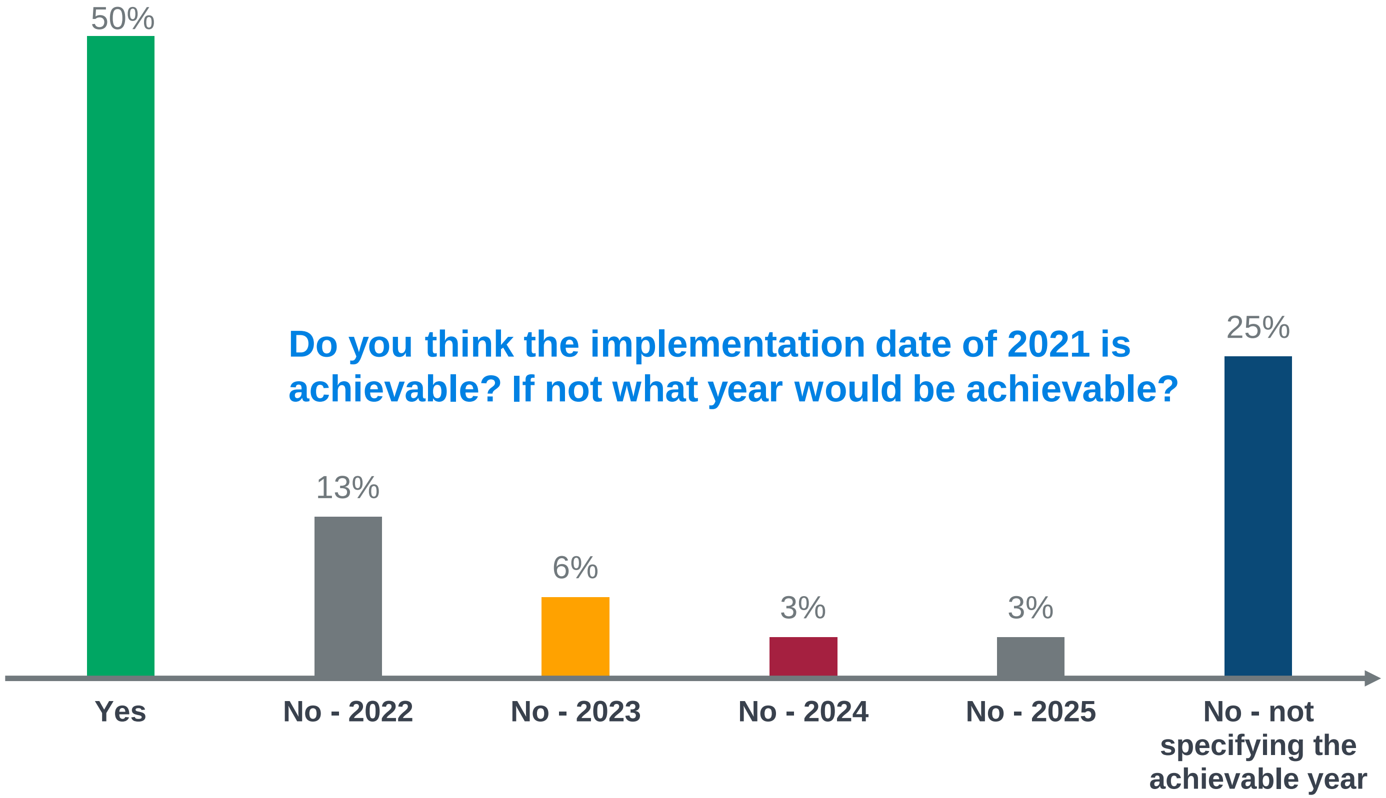
- ED proposes that coverage units become “service units”
- Can recognise acquired contracts in the liability for incurred claims
- Illustrative example on reinsurance contracts held added
- Changes in wording

Effective date

Still an area that some stakeholders are concerned about

✓ ?

2021 → 2022 ⇢ 2023



EFRAG welcomes the IASB's decision to defer the effective date of IFRS 17. However, EFRAG disagrees with 1 January 2022 as the effective date. ***EFRAG considers that 1 January 2023 is a realistic effective date, with early application permitted.***

Annual cohorts and transition

Still an area that some stakeholders are concerned about

*EFRAG acknowledges that the annual cohort requirement has been identified by the IASB as a practical simplification between developing a more principle-based solution that was dismissed as unduly burdensome and meeting the reporting objectives of the level of aggregation. Nonetheless, **EFRAG considers that this requirement leads to unnecessary cost in some fact patterns, in particular for contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts.***

***CFO forum/Insurance Europe:** We believe that the current limitations in the modified retrospective approach unduly limit the ability to utilise this transition method and **will result in too much default to the fair value approach**, even where this is less appropriate.*

***IAI:** For with direct participation feature business, we request further consideration towards relaxation of requirement to have annual cohorts - particularly where the economic substance of benefit payouts (and bonus determination) is such that these are determined together for policies issued over different calendar years. We request the board that choice of cohorts to be left up to the Company with appropriate disclosures setting out the basis for determining the cohorts.*