Amendments to IFRS 17 from April 2019 IASB Meeting

April 2019

Introduction

Following 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. These issues have been brought to the attention of the International Accounting Standards Board (**IASB** or the **Board**) through the Transition Resource Group for IFRS 17 (**TRG**), and also through industry bodies and groups such as the CFO Forum. This resulted in the IASB proposing, in November 2018, to postpone the effective date by a year to 1 January 2022 to give industry further time to prepare. Since October 2018, the IASB has also been considering amendments to the Standard to address some of the concerns raised.

April 2019 meeting

In the IFRS 17-related papers for the April meeting of the IASB, the IASB Staff (the **Staff**) say that the Board substantially completed its review of possible changes to the Standard at its March 2019 meeting.

Agenda Paper 2A[1] provides a summary of the **amendments** to the Standard that the Board has previously tentatively agreed (see the next section). The Staff also summarises its views on the likely effect of those amendments on financial statements relative to the Standard issued in May 2017, and the effects on the Staff's cost-benefit analysis of the May 2017 version.

Agenda Paper 2D[2] sets out proposed minor drafting amendments (referred to as **annual improvements**[3]) to the Standard, both those tentatively agreed by the Board in June 2018 and those that have been identified more recently.

Agenda Paper 2E[4] sets out some feedback from the TRG meeting held on 4 April on some of the annual improvements.

Some members of the TRG were concerned that the Staff's proposed clarification of the definition of "*investment component*" implies the need for greater analysis and disclosure of payments to policyholders than is currently the case. The Staff commented that this was not their intention.

It was agreed that the Staff should prepare a paper to clarify this point for consideration at the meeting of the Board scheduled for May.

In **Agenda Paper 2C**[5] the Staff recommended that the amendments in Paper 2A and the annual improvements in Paper 2D apply from the date that IFRS 17 applies and, once the amendments have been finalised, entities should be permitted early application of the amended Standard only.

The IASB agreed this recommendation.

Agenda Paper 2C also considers some further issues (referred to as **sweep issues**) raised by stakeholders (see below). The Staff recommended that no action is taken in respect of these.

The IASB agreed this recommendation.

Agenda Paper 2B[6] sets out the process followed to develop the proposed changes described in Papers 2A and 2D, and to prepare for publication an Exposure Draft (**ED**) setting out those changes. The Staff plans to seek approval for a shortened public consultation period for the ED.[7] It expects the Board to decide the period at its meeting in May, and **the ED to be published at the end of June 2019**.

Summary of the amendments

The amendments in Agenda Paper 2A include the deferral of the requirement to apply IFRS 17 to annual periods beginning on or after 1 January 2022, and the extension of the exemption in IFRS 4 from applying IFRS 9 *Financial Instruments* (**IFRS 9**), so all entities are required to apply IFRS 9 for annual periods beginning on or after 1 January 2022.

The other amendments (and the IASB meeting(s) at which they were considered) are as follows:

- Allowing the recognition of the Contractual Service Margin (**CSM**) to reflect the provision of *investment-related services* (where the Variable Fee Approach (**VFA**) is applied), or the provision of *investment-return services* (where the General Model (**GM**) is applied), as well as insurance services. This comes with additional disclosure requirements. (**June 2018, January and March 2019**).

[1] Agenda item 2A, 'Overview of the amendments to IFRS 17'.
[2] Agenda item 2D, 'Annual improvements'.
[3] A list of the annual improvements is provided at the end of this note.
[4] Agenda item 2E, 'Supplement to Agenda Paper 2D *Annual improvements* – feedback from TRG meeting held on 4 April 2019'.
[5] Agenda item 2C, 'Sweep Issues'.
[6] Agenda item 2B, 'Due process steps and permission for balloting'.
[7] With the consent of the Due Process Oversight Committee, the IASB can consider a comment period of no less than 30 days (rather than 120 days) if the matters covered by the Exposure Draft are narrow in scope and urgent.

- Requiring the *reporting* of insurance contract assets and liabilities using portfolios of insurance contracts, rather than annual cohorts (calculation must still be at annual cohort level). (**December 2018**)

- Allowing the deferral of insurance acquisition cash flows in relation to insurance contracts in groups yet to be issued. This comes with additional disclosure requirements. (**January and March 2019**).

- Requiring an entity that recognises losses on onerous insurance contracts at initial recognition to also recognise a gain on reinsurance contracts held, to the extent that the reinsurance contracts cover those losses on a proportionate basis and are entered into at or before the onerous contracts are issued. (**January 2019**).

- Amending the transition requirements in IFRS 17 for liabilities that relate to the settlement of claims incurred before an insurance contract was acquired as follows.

  - to modify the Modified Retrospective Approach so that an entity may classify such liabilities as a liability for incurred claims (nevertheless, the modification may still only be used to the extent that an entity does not have reasonable and supportable information to apply the Full Retrospective Approach); and
  - to permit an entity applying the fair value approach to choose to classify such liabilities as a liability for incurred claims. (**February 2019**).

- Permitting the application of either IFRS 9 or IFRS 17 to a portfolio of loan contracts that transfer significant insurance risks, provided the insurance coverage is only for the settlement of the policyholder's obligations created by the contract. There is a related amendment to the transition requirements in IFRS 9. (**February and March 2019**).

- Excluding from the scope of IFRS 17 those credit card contracts that provide insurance coverage for which the issuing 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. (**March 2019**).

The risk mitigation option

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 and loss, instead of adjusting the CSM. The corresponding amendments to the Standard will:

- permit the risk mitigation option to be applied for direct participation insurance contracts when the entity uses reinsurance contracts held to mitigate financial risks, not just when derivatives are held for this purpose. (**January 2019**);

- permit a prospective application of the risk mitigation option from the **transition date**[8], provided that the entity designates the relevant risk mitigation relationships no later than that date. (**March 2019**); and

- permit entities that have used derivatives or reinsurance contracts to mitigate financial risk arising from direct participation insurance contracts before the transition date, and also propose to use the risk mitigation option from 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. (**March 2019**).

The IASB agreed the amendments described in Paper 2A and the annual improvements described in Paper 2D (which are listed at the end of this note) be included in the Exposure Draft.

Summary of the sweep issues

Other than the postponing of the effective date of IFRS 17 by a year, the sweep issues in Agenda Paper 2C are as follows:

- One issue relates to arrangements where incoming and outgoing payments are settled net by a third party, and the (re)insurer does not receive contract level cashflows.

  Stakeholders are concerned that the requirement to provide disclosures that distinguish between the liability for incurred claims and the liability for remaining coverage would require extensive allocations of net cashflows.

  The Staff noted that the Board has previously tentatively decided to permit the reporting of insurance contract assets and liabilities using portfolios of insurance contracts, rather than annual cohorts. The Staff recommended that the Board takes no further action on this issue.

  The IASB agreed with the Staff's recommendation.

- There are differences between IFRS 17 and IFRS 9 in respect of the requirements for restating comparative information when the relevant standard is first applied. A stakeholder commented that this may deter an entity from restating prior periods that are optional.

  The Staff noted (i) the Board was aware of those differences when it considered the transition requirements for the two

[8] 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

standards, (ii) most entities have already applied the transition requirements of IFRS 9 and (iii) (re)insurers can mitigate some concerns by applying IFRS 9 for the first time before they apply IFRS 17 for the first time. The Staff recommended no action on this issue.

The IASB agreed with the Staff's recommendation.

- Some stakeholders are concerned about the accounting mismatches that could arise where an entity *chooses* to disaggregate insurance finance income/expense[9] between Profit & Loss (**P&L**) and Other Comprehensive Income (**OCI**) (the **OCI option**) for contracts under the GM, and that entity uses derivatives to mitigate the financial risks under those contracts (as the derivatives are measured at fair value through P&L under IFRS 9).

  The Staff noted (i) applying the OCI option is optional, (ii) the Board considered but declined to develop a bespoke solution for all hedging activities for insurance contracts, and (iii) the risk mitigation option in the VFA was only developed to address a potential new mismatch created by the VFA itself. The Staff recommended no action on this issue.

  The IASB agreed with the Staff's recommendation.

- Some stakeholders raised similar concerns to the previous issue where the VFA is used. In this case accounting mismatches could arise from an entity choosing to apply both the risk mitigation option and the OCI option for insurance contracts with direct participation features for which it uses derivatives to mitigate the financial risks.[10]

  This could be the case where, for example, derivatives are used to mitigate the risk arising from a guaranteed minimum investment return. Applying the risk mitigation option would mean that changes in the fulfilment cashflows related to the value of the guarantee would not adjust the CSM. Applying the OCI option as well would result in those changes being recognised in OCI, while changes in the value of the derivatives are recognised in P&L.

  The Staff commented that the observations made in respect of the corresponding issue for the GM (see above) apply here. In addition, they note that an entity that applies the VFA when holding the underlying items can consider whether

  - to apply the risk mitigation option to *reduce* accounting mismatches between the insurance contracts and the derivatives; or
  - apply the OCI option and recognise in P&L an amount of insurance finance income/expense that exactly offsets the income/expense included in P&L on the underlying items.

  The Staff recommended no action on this issue.

  The IASB agreed with the Staff's recommendation.

List of the 'annual improvements'

The annual improvements included in Paper 2D are intended to correct the Standard where the drafting may not achieve what the IASB intended. The changes are:

- to make clear that changes relating to the time value of money and financial risks should be excluded from the adjustments made to the CSM and recognised in P&L (or OCI) where the GM is used;
- where an entity chooses to disaggregate changes in the **Risk Adjustment**[11] between (i) those relating to the time value of money and financial risk and (ii) those relating to non-financial risk, then the entity may only adjust the CSM for item (ii) where the GM is used;
- to make clear that the change to a loss component (which captures the extent to which a group of insurance contracts is onerous) should reflect changes to the Risk Adjustment;
- to specify that an entity may only discontinue the application of the risk mitigation option to a group of insurance contract (see above) if the group no longer satisfies the eligibility criteria applicable to that option;
- to make clear that an investment component is the amount that an insurance contract requires the entity to repay to the policyholder in ***all*** circumstances[12];
- to make clear that if an investment component separated from a host insurance contact would meet the definition of an *investment contract with discretionary participation features* then that component should be accounted for applying IFRS 17;

[9] The 'insurance finance income or expense' (its full name) comprises the change in the carrying amount of a group of insurance contracts arising from (i) the effect of the time value of money and changes in the value of money and (ii) the effect of changes in assumptions that relate to financial risk.
[10] Insurance finance income or expense would adjust the CSM for direct participating insurance contracts unless the risk mitigation option is applied.
[11] This is referred to in IFRS 17 as the '*risk-adjustment for non-financial risks*'.
[12] As noted above, the concerns raised by some members of the TRG about this clarification are to be covered by a Staff paper to the IASB meeting scheduled for May.

- to avoid any unintended consequences of using the term "*issued*" rather than "*issued or expected to be issued*" in paragraph 27 of the Standard, which relates to the recognition of any insurance acquisition cashflows that an entity pays or receives before the group to which the cashflows relate is itself recognised;
- to make clear that changes in the measurement of a group of insurance contracts caused by changes in underlying items[13] (even where these items include non-financial assets) should be treated as changes related to the time value of money or assumptions that relate to financial risk;
- to clarify the intended timing of the recognition of contracts within a group when contracts in the group qualify for recognition over more than one reporting period;
- to remove the potential double counting of the Risk Adjustment in reconciliation disclosures and revenue analyses;
- to replace references to '*risk exposures*' by references to '*risk variables*' in the sensitivity analysis disclosure requirements in paragraphs 128 and 129 of IFRS 17;
- to exclude **common control transactions**[14] from the scope of the requirements for business combinations in IFRS 17;
- to clarify that the consequential amendments to IFRS 3 *Business Combinations* made by IFRS 17 on the classification of insurance contracts only apply prospectively;
- to prevent insurance contracts held being included in the scope of IFRS 7 *Financial Instruments: Disclosures*, IFRS 9 and IAS 32 *Financial Instruments: Presentations*; and
- to explain that in Example 9[15] of the Illustrative Examples on IFRS 17, which considers groups of insurance contracts with direct participation features, that the time value of the guarantee changes over time.

FURTHER READING

Milliman IFRS 17 update: January 2019 IASB meeting

Milliman IFRS 17 update: February 2019 IASB meeting

Milliman IFRS 17 update: March 2019 IASB meeting

The full Staff papers for the April 2019 IASB meeting

[13] Underlying items are 'investments' that determine the amount of some payments to policyholders.

[14] Combinations involving entities that are ultimately controlled by the same party or parties are referred to as '*common control transactions*'.

[15] Paragraphs IE99 to IE122.

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.

If you would like to discuss any of the above, or anything else, with us, or if you have any questions or comments on this paper then please contact one of the named consultant(s) below or your usual Milliman consultant.

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CONTACT

Andrew Gilchrist
andrew.gilchrist@milliman.com