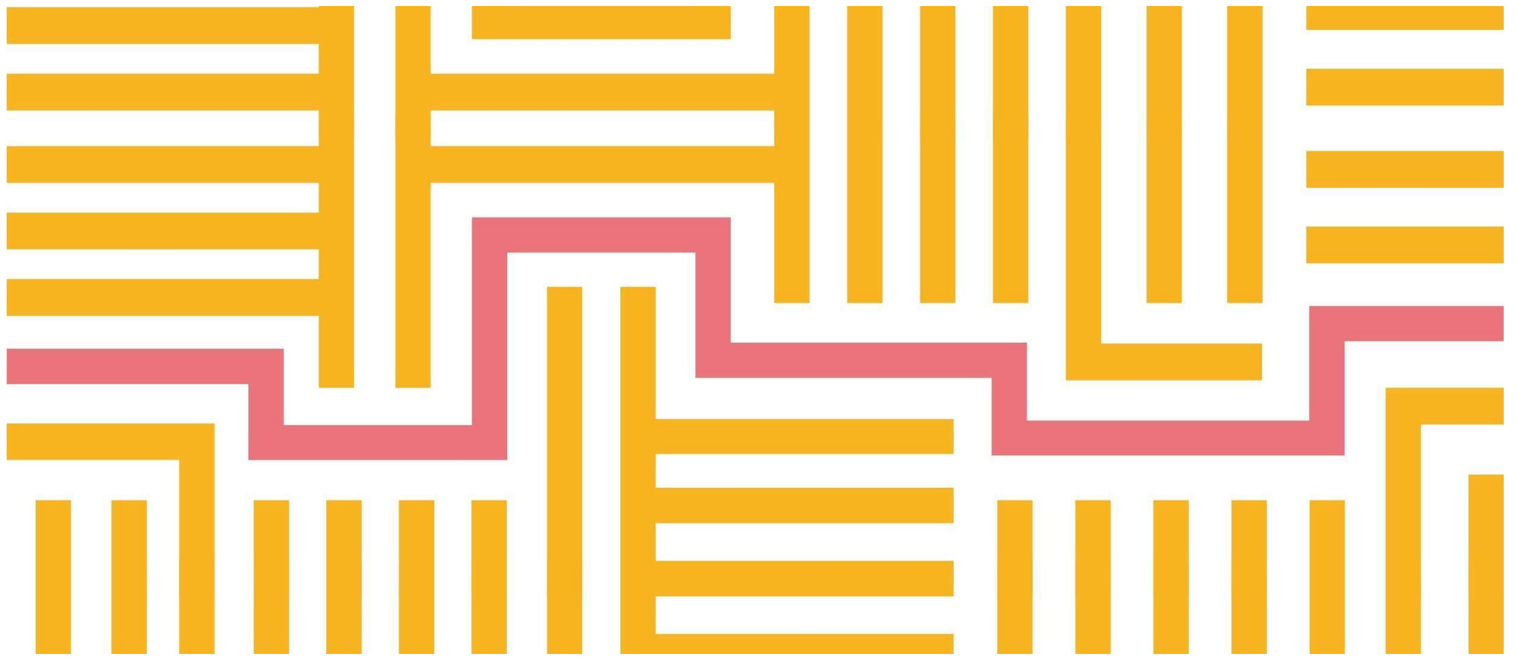

In transition

The latest on IFRS 17 implementation

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The IASB extends the scope exclusion from IFRS 17 for some credit card contracts and provides an accounting policy choice related to interim reporting

At a glance

On 30 January 2020, the IASB ('Board') tentatively decided to modify its proposals in the Exposure Draft so that IFRS 17 would be amended:

- to extend the scope of the proposed scope exclusion for credit cards, to apply also to other similar contracts that provide credit or payment arrangements, and to require that IFRS 17 would apply to the insurance coverage component of such contracts;
- to provide, at a reporting entity level, an accounting policy choice as to whether to change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements or in the annual reporting period; and
- to require an entity to identify, recognise and measure an asset for insurance acquisition cash flows at the transition date, and to specify how the modified retrospective approach and fair value approach would apply in determining that asset.

The Board also tentatively decided to retain, unchanged, the requirements in IFRS 17 relating to:

- insurance contracts acquired in their settlement period in a transfer of insurance contracts that do not form a business or in a business combination within the scope of IFRS 3, 'Business Combinations'; and
- the prohibition from applying the risk mitigation option retrospectively.

The views in this In transition are based on our observations from the 30 January 2020 meeting, and they might differ in some respects from the official report of the meeting that will be published by the IASB in an IASB Update at a later date.

Background

1. On 26 June 2019, the Board published the Exposure Draft, 'Amendments to IFRS 17' ('ED'). The ED responded to some of the concerns and challenges raised by stakeholders, proposing amendments intended to support entities implementing IFRS 17. The proposals were intended to reduce implementation costs and to make it easier for entities to explain results from applying IFRS 17 to users of financial statements.

2. Since the ED's 90-day comment period ended on 25 September 2019, the Board discussed the feedback from outreach and comment letters on the ED, and it decided on an approach for re-deliberating the matters raised by respondents.

3. As part of that approach, the Board has indicated that:

- It would finalise some of the proposals in the ED without substantive re-deliberation.
- It would not consider further some of the topics identified in the feedback from respondents, thus reducing uncertainty about any possible amendments to IFRS 17.
- It would continue to apply the criteria that the Board set when deciding to propose amendments to IFRS 17. Thus, the Board would seek to ensure that any amendments to IFRS 17 do not:
  - change the fundamental principles of the standard, because that would result in a significant loss of useful information for users of financial statements relative to that which would otherwise result from applying IFRS 17;
  - unduly disrupt implementation already underway; or
  - further delay the effective date of IFRS 17.

4. At its December 2019 meeting, the Board had:

- tentatively decided to finalise six proposed amendments without substantive re-deliberation;
- confirmed the proposals in the ED relating to the recovery of insurance acquisition cash flows; and
- decided to extend the scope of the amendments relating to accounting for the recovery of losses for reinsurance contracts held on the date of recognition of onerous direct contracts to all reinsurance contracts held, rather than only to those that provide proportionate coverage.

Items discussed during the January Board meeting

5. At its January 2020 meeting, the Board discussed the proposals relating to:

- the scope exclusion for some credit card contracts that meet the definition of an insurance contract;
- the prohibition from applying the risk mitigation option retrospectively on transition to IFRS 17;
- the accounting for contracts acquired in their settlement period in a transfer of insurance contracts that do not form a business or in a business combination within the scope of IFRS 3; and
- the requirement relating to interim financial statements in IFRS 17, that an entity does not change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in its annual reporting period.

6. In addition, the Board continued its discussion from December 2019, by considering the transition and business combination requirements relating to the accounting for insurance acquisition cash flows.

PwC Observation:

The Board has made significant progress in finalising 13 of the 19 topics that it decided that it would consider in its re-deliberations of the ED. While there are still some significant issues to be considered on a challenging timetable, the staff commented that the Board is 'on track' with its timetable.

Scope exclusion from IFRS 17 for some credit card contracts

7. The Board tentatively decided to confirm the proposed scope exclusion from IFRS 17 with some changes, and to extend it to apply to other similar contracts that provide credit or payment arrangements.

8. Accordingly, IFRS 17 will be amended to require an entity to exclude from the scope of IFRS 17 insurance contracts that provide credit or payment arrangements similar to credit card contracts 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. If the entity provides the insurance coverage to the customer as part of the contractual terms of such a contract, the entity is required to:

- separate that insurance coverage component and apply IFRS 17 to it; and
- apply other applicable IFRS standards, such as IFRS 9, 'Financial Instruments' to the other components of the contract.

PwC Observation:

The IASB's decision is consistent with the feedback from many of the respondents who commented on the proposed scope exclusion for credit cards. Board members commended the feedback from stakeholders that identified issues relating to the accounting for undrawn loan commitments under the ED proposals. The decision also responds to concerns about:

- the measurement, applying IFRS 9, of credit card contracts that provide insurance coverage, because insurance coverage-related cash flows could result in the whole contract being measured at fair value through profit and loss (because those cash flows are not solely payments of principal and interest); and
- the treatment of other insurance contracts regarded as similar to credit cards, such as debit cards, charge cards, consumer financing contracts, current and deposit accounts and overdraft facilities that would not otherwise qualify for the scope exclusion.

This treatment differs from most existing practice for credit cards with insurance coverage, in which a provision for any claims arising under such insurance coverage is recognised applying IAS 37. For credit cards where insurance coverage is provided as a result of law or regulation, that existing practice will be able to continue. In contrast, applying the IASB's decision, insurance coverage provided under contractual terms would be accounted for using IFRS 17. The Board considered the extent to which its decision would create practical difficulties for entities that might need to apply IFRS 17 only because they issue credit cards with insurance coverage. However, Board members concluded that this requirement would arise only where an entity has chosen to offer insurance coverage, and that applying IFRS 17 was therefore appropriate.

In our view, operational difficulties for banks are likely to be limited, because most banks are able to withdraw the credit card with no notice. This means that the insurance coverage would have a short contract boundary, which will reduce any differences in practice compared to the accounting treatment for many credit card contracts where insurance coverage is provided under contractual terms.

Board members observed that the drafting should be clear that the Board intended that its decision would also apply to debit card arrangements, and that the reference to 'cards' was not intended to limit the decision to situations where there was a physical card.

Prohibition from applying the risk mitigation option retrospectively on transition to IFRS 17

9. The risk mitigation option in IFRS 17 permits an entity to recognise immediately in profit or loss some or all of the changes in the effect of financial risk on insurance contracts with direct participation that usually adjust the contractual service margin. In other words, the risk mitigation option 'switches off' the variable fee approach to the extent that financial risk is mitigated.

10. IFRS 17 prohibits an entity from applying the risk mitigation option for periods before the date of initial application of IFRS 17, due to the Board's concerns about the risk of the use of hindsight. The Board tentatively decided that it would retain, unchanged, the prohibition from applying the risk mitigation option retrospectively.

11. The Board had, in its December 2019 meeting, finalised related amendments that would:

- permit an entity to apply the option prospectively from the transition date rather than the initial application date, addressing concerns about inconsistency between the first reporting period applying IFRS 17 and restated comparative information; and

- permit an entity to apply the fair value approach for groups of insurance contracts with risk mitigation relationships, even if an entity is able to apply IFRS 17 retrospectively, thus avoiding any accounting mismatches because any past gains or losses on derivatives and any effects of past changes in financial risk on the group of insurance contracts would both be reflected in opening retained earnings.

PwC Observation:

There have been differing views between the Board and those stakeholders that believe that the comparability of information before and after transition would be enhanced by permitting retrospective application of the risk mitigation option. In contrast, the Board is primarily concerned that permitting such retrospective application would reduce the credibility of information presented, by creating opportunities for entities to decide the risk mitigation relationships to which to apply the option based on the known accounting outcome. The ED therefore set a challenge for stakeholders to provide suggestions on how those concerns could be addressed. The tentative decision reflects the Board's conclusion that those suggestions would not adequately address its concerns.

As suggested in some comment letters, the Board reconsidered whether it should permit an entity to apply an 'all or nothing' retrospective application of the risk mitigation option to reduce the risk of the use of hindsight. Some Board members commented that they had hoped that the feedback on the ED would meet the challenge of resolving the 'cherry picking' issue that it had identified in the ED. However, the feedback on the ED had not identified any suitable way to address that issue. The Board discussed the features of an 'all or nothing' approach that would be needed to avoid the ability to cherry pick, noting that:

- concerns about inconsistency in the treatment of risk mitigation activities could be addressed only if an 'all or nothing' approach to retrospective application of the risk mitigation option were to be applied at a reporting entity level to all *past and current* derivatives and reinsurance contracts held that are at the transition date, or were in any previous reporting period, and that were used to mitigate financial risks on those groups of insurance contracts;
- to comply with the documentation requirements for the risk mitigation option in IFRS 17 retrospectively, all documentation would need to have existed at the beginning of the first reporting period in which the entity would have met the conditions to apply the risk mitigation option; and
- to apply an 'all or nothing' approach retrospectively, an entity would also have needed to be able to measure all groups of insurance contracts with direct participation features that existed at the transition date retrospectively, including determining the effect of applying the option. The Board did not think that permitting any reliefs or modifications for measuring the effect of applying the option in the full retrospective approach would be appropriate, because doing so would be inconsistent with that approach.

The Board concluded that meeting the conditions necessary to apply an 'all or nothing' approach retrospectively would be a very high hurdle that would likely be met in only a narrow set of circumstances and would be impracticable in almost all cases. As a result, the Board decided to confirm the proposals in the ED.

Accounting for contracts acquired in their settlement period

12. Contracts acquired in their settlement period refers to contracts acquired by an entity after the occurrence of an event that triggered a valid claim by the policyholder but before the ultimate cost of the claim becomes known. For such contracts, the insured event for the acquiring company is the determination of the ultimate cost of the claim because there is no longer any uncertainty about whether the insured event specified in the policy will occur.

13. The Board tentatively decided to retain, unchanged, the requirements in IFRS 17 for insurance contracts acquired in their settlement period in a transfer of insurance contracts that do not form a business or in a business combination within the scope of IFRS 3.

14. The Board had, in its December 2019 meeting, finalised related transition reliefs in the modified retrospective approach and the fair value approach that would permit an entity to classify a liability for insurance contracts acquired in their settlement period prior to the transition date as a liability for incurred claims rather than a liability for remaining coverage if the entity does not have reasonable and supportable information to apply a retrospective approach.

PwC Observation:

The requirements in IFRS 17 for contracts acquired in their settlement period are a significant change from many existing insurance accounting practices. Staff noted that the Board had received correspondence since the papers were posted, indicating disagreement with the staff recommendation, similar to that noted in the comment letters. Nonetheless, the Board concluded that creating an exemption from the general requirements for determining the insured event would create complexity for users of financial statements in applying the definitions of 'insured event' and 'coverage', and reduce comparability with the requirements for other transactions.

The Board acknowledged concerns that this requirement might impose costs, in particular because it might require the use of the general model for contracts acquired in their settlement period, when originated contracts of the same type would have been eligible for the premium allocation approach. However, the Board noted that it had considered the cost-benefit balance in developing the ED, and it believed that the benefit of applying general principles and consistent business combination accounting for all types of transactions outweighed the operational costs that would be imposed. Some Board members also commented that operational costs associated with business combination accounting are not unique to contracts that are accounted for applying IFRS 17.

Interim financial statements

15. Paragraph B137 of IFRS 17 requires an entity not to change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements or in the annual reporting period. IFRS 17 generally requires changes in estimates related to a future period to adjust the contractual service margin, whereas experience adjustments (that is. differences between expected and actual amounts in the current and past period) are recognised in profit or loss immediately. Thus the accounting depends on the timing of a reporting date.

16. The Board tentatively decided to amend the requirement relating to interim financial statements in paragraph B137 of IFRS 17 to permit an entity an accounting policy choice as to whether to change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements or in the annual reporting period. The accounting policy choice would apply to all insurance contracts issued and reinsurance contracts held by the entity.

PwC Observation:

The Board noted that this issue presented a trade-off between a pragmatic approach to address feedback, and the introduction of additional complexity by introducing a new accounting policy choice. The Board was concerned about the implications for comparability that arise when a new accounting policy choice is introduced. However the Board was also sympathetic to the feedback from stakeholders that what had been intended as an operational relief would result in a more significant practical burden than the burden that it had intended to alleviate. At the same time, the Board was concerned that deleting the requirement in paragraph B137 might unduly disrupt implementation for entities that might need to revisit the work that they have already done to develop systems and processes to comply with this paragraph.

The Board discussed whether to amend IFRS 17 in a way that would avoid the need for a subsidiary that does not prepare interim financial reports as defined in IAS 34 to account for its contracts on the basis of the frequency of reporting at the consolidated level, as suggested by some stakeholders. However, the Board concluded that doing so would add complexity for both preparers and users of financial statements, reduce comparability between entities and would not avoid a subsidiary preparing two sets of accounting estimates, for example if internal reports prepared by a subsidiary for consolidated purposes that might differ the parent's financial statements due to intercompany transactions and business combinations. In some situations, the Board's tentative decision to allow the parent to change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in the annual reporting period, would enable the parent to align with the subsidiary's accounting estimates, by allowing the parent to elect to change its interim reporting between the year to date and year end financial statements.

Acquisition cash flows - transition and business combinations

17. At its December 2019 meeting, the Board had tentatively decided to finalise amendments to IFRS 17 relating to the expected recovery of insurance acquisition cash flows. At its January 2020 meeting, the Board addressed the consequences of that decision for transition and for business combinations.

Recognition of an asset for insurance acquisition cash flows at transition

18. The Board tentatively decided to require an entity, unless impracticable, to identify, recognise and measure an asset for insurance acquisition cash flows retrospectively at the transition date. Such an asset would arise when acquisition cash flows relating to a portfolio of insurance contracts would have been allocated to future unrecognised groups of renewed contracts applying IFRS 17, and therefore there would have been an asset at the transition date if IFRS 17 had been applied retrospectively. If, and only if, it is impracticable for the entity to measure an asset for insurance acquisition cash flows at the transition date the entity would apply either the modified retrospective approach or the fair value approach. The Board noted that the assessment of impracticability should be at the level of a group of insurance contracts.

19. The Board specified additional modifications in the modified retrospective approach and the fair value transition approach to assist entities that do not have reasonable and supportable information to apply a retrospective approach to determine an asset for insurance acquisition cash flows. The Board also included in the modified retrospective approach an additional modification that would prevent an entity from not being allowed to use the modified retrospective approach and being required to use the fair value approach solely because of a lack of information about insurance acquisition cash flows.

Recognition of an asset for insurance acquisition cash flows in a transfer of insurance contracts that do not form a business and in a business combination within the scope of IFRS 3

20. The Board tentatively decided to amend IFRS 3 and IFRS 17 to require an entity that acquires insurance contracts in a transfer of insurance contracts that do not form a business or in a business combination within the scope of IFRS 3 to recognise a separate asset for insurance acquisition cash flows measured at fair value at the acquisition date.

Impairment test considerations on transition

21. The Board clarified that on transition to IFRS 17, an entity is not required to identify retrospectively whether there were facts and circumstances in the period earlier than the transition date indicating potential impairment of an asset for insurance acquisition cash flows recognised. The Board noted that the same effect will be captured by applying the recoverability assessment at the transition date.

PwC Observation:

The response to the ED raised questions about how entities would determine the asset for insurance acquisition cash flows on transition and in business combinations. Although this issue already existed in IFRS 17, as issued in May 2017, the amendments for insurance acquisition cash flows increased the potential significance of the asset. The modifications address those questions in a pragmatic way, while avoiding an important pitfall for entities that intend to apply the modified retrospective approach but might have been prevented from doing so because of lack of information about insurance acquisition cash flows. The modifications do, however, add complexity to the requirements relating to the modified retrospective approach and the fair value transition approach.

Next steps

22. The Board confirmed that, as stated in the ED, its objective is to issue the final amendments to IFRS 17 in mid-2020. The staff confirmed that the Board is on track with its plan, which would see the remaining technical topics discussed at its February 2020 meeting. The staff also confirmed that it expects to consider the proposed effective date of IFRS 17 and the proposed extension of the IFRS 9 temporary exemption in IFRS 4 in March 2020, to allow the Board to take a holistic view of the amendments.

23. The following table summarises which topics the Board expects to consider in future meetings:

Topics already discussed	Topics to be considered at a future meeting
Question 1: Scope exclusions	
Scope exclusions for loans and credit cards	
Question 2: Expected recovery of insurance acquisition cash flows	
Asset for expected recovery of insurance acquisition cash flows	
Question 3: Contractual service margin attributable to investment services	
Coverage units for insurance contracts with direct participation features	Coverage units for insurance contracts without direct participation features, disclosures and terminology
Question 4: Reinsurance contracts held - recovery of losses	
Recovery of losses for reinsurance contracts held	
Question 5: Presentation in statement of financial position	
Presentation of insurance contract assets and liabilities at a portfolio instead of group level	
Question 6: Applicability of the risk mitigation option	
Applicability of risk mitigation option for reinsurance contracts held	Applicability of risk mitigation option for non-derivative financial instruments at fair value through profit or loss
Question 7: Effective date	
	Deferral of the effective date of IFRS 17 Extension of the IFRS 9 temporary exemption in IFRS 4
Question 8: Transition reliefs	
Relief for insurance contracts acquired in a business combination before transition to IFRS 17 by permitting a liability for settlement of claims incurred before an insurance contract was acquired to be classified as a liability for incurred claims Transition reliefs for the risk mitigation option: ● application from the transition date ● option to apply the fair value approach Prohibition from applying risk mitigation option retrospectively Transition modifications and reliefs related to insurance acquisition cash flows	Additional specific transition modifications and reliefs suggested in comment letters, other than those related to insurance acquisition cash flows

Question 9: Minor amendments	
	Specific feedback on minor amendments and editorial corrections, including the proposed amendment to paragraph B107
Topics not proposed in the ED	
Classification in a business combination of contracts acquired in their settlement period Paragraph B137 of IFRS 17 relating to interim financial statements	Annual cohorts for insurance contracts with intergenerational sharing of risks between policyholders

Find out more in PwC's publications and resources related to IFRS 17:

- In transition INT 2019-09
- In transition INT 2019-08
- In transition INT 2019-07
- In brief INT 2019-09 *Proposed amendments to IFRS 17, 'Insurance contracts'*
- Illustrative IFRS consolidated financial statements 2019 - Insurance

PwC clients who have questions about this In transition should contact their engagement partner.

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