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Amendments to IFRS 17 on the IASB Board agenda

IASB clarifies certain IFRS 17 requirements through its annual improvement amendment process

At a glance

On 21 June 2018 the IASB Board agreed to make clarifying amendments to IFRS 17, 'Insurance Contracts', to ensure that the words in the standard reflect the decisions made by the Board during its deliberations. The Board agreed to clarify that, for contracts subject to the variable fee approach, the determination of coverage period and quantity of benefits should include investment-related services in addition to insurance coverage. The Board also agreed to clarify that the consequential amendment in IFRS 3, 'Business Combinations', on the classification of insurance contracts applies prospectively; and, separately, that business combinations under common control are excluded from the scope of the requirements for business combinations in IFRS 17. Several other clarifying amendments were also approved on other topics.

The views in this In transition are based on our observations from the 21 June meeting, and they might differ in some respects from the official minutes of the meeting to be published by the IASB at a later date.

Background

1. In connection with the issuance of IFRS 17, the IASB established a transition resource working group ('the TRG') to provide a public forum for stakeholders to follow the discussion of questions raised on implementation of the new standard. The purpose of the TRG is to facilitate a public discussion to provide support for stakeholders and information to the Board on implementation questions arising from the application of IFRS 17.

2. After issuance of the standard, IASB staff have also been engaged in a variety of activities with stakeholders to follow the implementation of IFRS 17. During these activities, and through the TRG discussions, the staff have become aware of several instances where the standard might be interpreted in ways that were not intended by the Board.

3. All of the amendments agreed to by the Board at the 21 June meeting relate to what are referred to as 'annual improvement' amendments. Amendments that are classified as

annual improvements are minor changes that clarify the words in a standard or correct relatively minor unintended consequences, oversights, or conflicts between existing requirements in a standard. The annual improvement process follows the same due process as all other amendments, including exposure for public comment. Additional background on the due process for IFRS standards can be found on the IASB website.

Summary of proposed annual improvement amendments

Clarification of coverage period for contracts with direct participating features

4. The TRG discussed amortisation of the contractual service margin (CSM) for contracts that qualify for the variable fee approach (VFA) at its meeting on 2 May 2018 (see INT 2018-02). It was agreed that the coverage period should include the period over which investment services are provided in addition to the insurance coverage period. This is because IFRS 17 acknowledges that such contracts 'are substantially investment-related service contracts', and this perspective is fundamental to the requirements of the VFA and to its scope.

5. At the 21 June Board meeting, the staff proposed that the Board should amend the definition of 'coverage period' for contracts that qualify for the VFA, to clarify this intended principle. In Appendix A to IFRS 17, a second paragraph would be added to the definition of 'coverage period' that would state: *"For insurance contracts with direct participation features, the period during which the entity provides coverage for insured events or investment-related services. This period includes the coverage for insured events or investment-related services that relates to all premiums within the boundary of the insurance contract".*

6. Most Board members agreed that the change in the definition of the coverage period for contracts under the VFA would be a clarification of the fundamental principle rather than a change to the existing standard, and thus would meet the criteria of an annual improvement amendment. One member voiced concern about making the change without, at the same time, addressing concerns raised by TRG members at the 2 May meeting with regard to the coverage period for contracts following the general model that also include investment-related services, as further described below.

7. All Board members, except one, agreed that the proposed amendment to the definition of coverage period for contracts with direct participation features (VFA contracts) should be included in the next Annual Improvements to IFRS Standards Cycle.

Coverage period for contracts without direct participation features

8. At the 2 May TRG meeting, the staff noted that other contracts with investment components that do not qualify for the VFA do not provide 'investment-related services' as defined in IFRS 17. They therefore noted that the determination of quantity of benefits for these contracts for CSM allocation should be based solely on the coverage period of insurance services, and that the determination should exclude consideration of the benefits provided relating to the investment component.

9. However, most TRG members disagreed, noting that contracts under the general model could also include investment-related services. At the 2 May TRG meeting, many TRG members suggested that the definition of 'coverage period' for such contracts should also be amended to include these services.

10. At the 21 June IASB meeting, the Board agreed not to propose any amendment to the definition of the coverage period for insurance contracts without direct participation features as part of the annual improvement amendments. It noted that such a change

would not be a minor amendment, but instead would constitute a significant reconsideration of the standard's provisions. Therefore, it was noted that further analysis and discussions are required for such contracts. The staff stated that, after the September 2018 TRG meeting, they would report back on matters where the TRG had not reached a conclusion, and the IASB chair agreed that the Board could discuss the general model coverage period issue at that time.

PwC observation

At the 2 May TRG meeting, it was noted that the amounts credited to many general model 'indirect participation contracts' are based on an asset return less an amount retained by the insurer ('spread'), and the related cash flows are then discounted using the asset-based rate (as illustrated in Example 6 of the standard). Because the insurance component is often less significant, this spread can be a major component of the CSM. People are concerned that the CSM is recognised over only the insurance coverage period of the contract. A similar point was made by one IASB Board member at the 21 June meeting, illustrated with a contract that had a one-year insurance coverage period and also provided five years of investment-related services.

Other proposed amendments

11. The Board agreed that IFRS 17 (and other standards, as applicable) will be amended to clarify that:

- the consequential amendment in IFRS 3, 'Business Combinations', on the classification of insurance contracts applies prospectively (that is, to those transactions entered into after the date of initial application of IFRS 17);
- business combinations under common control are excluded from the scope of the requirements for business combinations in IFRS 17;
- under paragraph 27 of IFRS 17, insurance acquisition cash flows relating to insurance contracts in the group include those relating to contracts issued and 'expected to be issued';
- under paragraph 28 of IFRS 17, in recognising a group of insurance contracts, an entity should include only contracts that meet the recognition criteria, applied to each contract, rather than those 'issued by the end of the reporting period';
- the IFRS 17 sensitivity analysis disclosures should show how profit or loss and equity would have been affected by changes in 'risk variables' rather than changes in 'risk exposures';
- some amount of risk adjustment for non-financial risk might be captured in other components in the IFRS 17 insurance contract reconciliations and revenue analyses which was not recognised in the existing disclosure wording and could have led to potential double counting of the risk adjustment in the disclosures;
- insurance contracts, as defined in IFRS 17, which would include those held as well as those issued and subject to IFRS 17, are exempt from the requirements of financial instruments standards (IFRS 7, IFRS 9 and IAS 32), except as otherwise noted; and
- the IASB illustrative Example 9 in IFRS 17 includes estimates of the time value of the death benefit guarantee embedded in the contract at initial recognition. An explanation will be added to indicate what factors are included, even though the numbers cannot be derived.

The Board agreed that the proposed amendments outlined above should be included in the next Annual Improvements to IFRS Standards Cycle.

PwC observation
The scope exclusion of business combinations under common control from the scope of the requirements for business combinations in IFRS 17 will allow companies to adopt an appropriate accounting policy. This could include predecessor accounting, which is often used for common control business combinations today.

What's next

12. The Board voted to include the amendments in the next Annual Improvements to IFRS Standards Cycle. The IASB normally allows a minimum period of 90 days for comment on annual improvements

PwC has developed the following publications and resources related to IFRS 17, 'Insurance Contracts':

- In transition INT2018-02: *Insurance TRG addresses unit of account, contract boundary, and coverage unit issues*
- In transition INT2018-01: *Insurance TRG holds its first meeting on IFRS 17*
- In brief INT2017-05: *IFRS 17 marks a new epoch for insurance contracts*
- In depth INT2017-04: *IFRS 17 marks a new epoch for insurance contract accounting*
- *Using Solvency II to implement IFRS 17*
- *IFRS 17 – Redefining insurance accounting*

PwC clients who would like to obtain any of these publications, or have questions about this In transition, should contact their engagement partner.

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