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IASB agrees to propose limited changes to balance sheet presentation of insurance contract assets and liabilities

The IASB continued its discussions on IFRS 17 and agreed to a narrow-scope amendment to the Standard

At a glance

On 13 December 2018 the IASB continued to discuss concerns and implementation challenges raised by stakeholders on IFRS 17. The IASB agreed to propose one narrow-scope amendment to require presentation of insurance contracts on the balance sheet at the portfolio level rather than at the grouping level used for contract measurement purposes.

The meeting covered 12 other implementation challenges, for which the IASB agreed not to amend the standard given that the concerns did not meet the agreed upon criteria for potential amendment. These criteria include whether amending the requirements could cause a significant loss of useful information relative to that which would be provided by IFRS 17 for users of the financial statements, unduly disrupt implementation processes that are already under way, or risk undue delays in the effective date. In addition, the Board agreed that the concern related to prospective application at transition of the risk mitigation exception in the variable fee approach should be discussed along with interrelated concerns on transition at a future meeting.

The views in this In transition are based on our observations from the 13 December 2018 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 ('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. Since the issuance of the standard, IASB staff have also been engaged in a variety of activities with stakeholders to follow the implementation of IFRS 17. At the IASB meeting on 24 October, the Board agreed to explore potential amendments to IFRS 17 based on a list of implementation issues and concerns compiled by the staff. The Board noted that the criteria sets a high hurdle for change, and any amendments suggested would need to be narrow in scope and deliberated quickly to avoid significant delays in the effective date. Refer to our In Transition: IASB agrees on criteria for evaluating any future potential amendments to IFRS 17.

3. In November, the IASB Board agreed to start the process to amend IFRS 17 to defer the mandatory effective date of IFRS 17 by one year. Subject to IASB due process, entities will be required to apply IFRS 17 for annual periods beginning on or after 1 January 2022. The Board noted that limiting the deferral to one year would minimise disruption to entities that are furthest advanced in implementation, address users' concerns that adoption of IFRS 17 and IFRS 9 should not be significantly delayed, and provides a clear signal to the industry that it should not stop implementation projects. Refer to our In transition: IASB proposes to amend the effective date of IFRS 17 and extend the temporary exemption of IFRS 9 for insurers.

Overview of items discussed during the December IASB Board meeting

4. At its 13 December meeting, the IASB Board discussed 13 concerns and implementation challenges reported to the IASB Board in October. Below is the summary of decisions reached by the IASB on concerns and implementation challenges discussed in the December Board meeting:

Staff paper	*Concerns and implementation challenges*	*IASB decision*
Presentation of insurance contracts on the statement of financial position (Staff Paper 2A)	Separate presentation of groups of assets and groups of liabilities	Amend
	Premium received under premium allocation approach	Not amend
	Separate presentation and measurement of premiums receivable and claims payable	Not amend
Discount rates, risk adjustment and OCI option (Staff Paper 2B)	Use of locked-in discount rates to adjust the contractual service margin	Not amend
	Risk adjustment in a group of entities	Not amend
	Subjectivity in the determination of discount rates and risk adjustment	Not amend
	OCI option for insurance finance income or expenses	Not amend
Variable fee approach (Staff Paper 2C)	Definition of an insurance contract with direct participation features	Not amend
	Risk mitigation exception in the variable fee approach	Scope not amended, retrospective application to be discussed at a future meeting
Business combinations (Staff Paper 2D)	Classification of acquired contracts as insurance contracts in a business combination	Not amend
	Identification of insured event for insurance contracts acquired in a business combination	Not amend
Future cash flows in the measurement of reinsurance contracts held (Staff Paper 2E)	Future cash flows in the measurement of reinsurance contracts held	Not amend
Treatment of accounting estimates in interim financial statements (Staff Paper 2F)	Treatment of accounting estimates in interim financial statements	Not amend

Presentation of insurance contracts on the statement of financial position

Separate presentation of groups of assets and groups of liabilities

5. The Board agreed that it should propose to amend IFRS 17 such that an entity would present separately in the statement of financial position the carrying amount of *portfolios* (rather than groups) of insurance contracts issued that are assets, insurance contracts issued that are liabilities, reinsurance contracts held that are assets, and reinsurance contracts held that are liabilities. A portfolio of insurance contracts is defined in IFRS 17 as insurance contracts subject to similar risks and managed together. However a few Board members expressed concerns that this proposal is contrary to the conceptual framework and IAS 32, one member noted that users subject to outreach believed there would not be a significant loss of information, and other Board members expressed the view that the operational concerns noted by preparers outweighed any IAS 32 inconsistency.

6. It was emphasised that it is only the presentation in the balance sheet that is proposed to be changed. Entities are still required to follow the recognition and measurement criteria at the group of insurance contracts level.

7. The Board agreed that this practical relief was aligned with the criteria for amendments agreed upon in October. Several insurers had reported that presentation requirements would require a significant change in existing premium and claims systems due to the lack of linkage between these systems and insurance asset/liability measurement systems and that creating an interface would be extremely costly. On balance, the Board believes that the costs would outweigh the benefits introduced by the group level presentation requirements. In addition, during outreach activities, analysts and investors indicated that they were less concerned with the presentation on the balance sheet since profit or loss remains unchanged and will continue to depict the benefits introduced by IFRS 17 which they appreciated.

Premium received under premium allocation approach ('PAA')

8. Interrelated with the system implications arising out of the presentation discussed above, stakeholders have also expressed concerns about the measurement requirements of the PAA, which establishes a liability for remaining coverage only when premiums are actually received. Preparers have indicated that under their current systems, the unearned premium liability is recorded as premiums are due or written.

9. It was noted in the analysis in the staff paper that the PAA is a simplification of the requirements in the general model, and therefore changing measurement requirements for the PAA would result in the model being different from the general measurement model. While the issue was one of the original reported concerns, it was not subject to a formal vote at the meeting but the above analysis was included in the staff paper.

Separate presentation and measurement of premiums receivable and claims payable

10. The Board agreed not to amend IFRS 17 for this issue. IFRS 17 requires an entity to present the combination of rights and obligations arising from a group of insurance contracts as a single asset or liability, which is consistent with the IFRS 17 measurement of a group of insurance cash flows as a package of cash inflows and outflows. Some stakeholders believe that premiums receivable and claims payable should be measured and presented separately, as they are today. They believe that separately presenting and measuring these amounts applying IFRS 9 would provide better information about their risks, particularly credit risk.

11. The Board observed that requirements for the measurement of groups of insurance contracts are a fundamental feature of IFRS 17 and that measuring and presenting components of the net insurance contract asset or liability as separate line items in the statement of financial position would indicate that those line items are not related to

each other. Hence, the Board noted that amending the standard to measure and present premiums receivable and claims payable as separate line items did not meet the agreed criteria for amendment. However, the staff paper noted that an entity may be able to present a disaggregation showing the components of the prescribed insurance asset or liability line items (for example, to present the amounts of premiums receivable and claims payable included in the carrying amount of the insurance contract liability).

Discount rates, risk adjustment and OCI option

Use of locked-in discount rates to adjust the contractual service margin ('CSM')

12. The IASB Board agreed not to amend the IFRS 17 requirement to use a locked in discount rate to adjust the CSM. It believes it would not be possible to amend the requirements in IFRS 17 relating to the discount rates used to determine the adjustment to the CSM in a way that would meet the criteria for amendments agreed by the Board.

13. The IASB has both during the deliberations of IFRS 17 and subsequent to issuance received feedback related to the use of the locked in discount rates when the CSM is updated for changes in estimated cash flows related to future service. The Board observed that applying a current rate to adjust the CSM (and accrete the CSM) would distort one of the principles introduced by IFRS 17, which is to present the insurance service result separately from the insurance finance income or expenses.

Risk adjustment in a group of entities

14. The Board members agreed not to amend the standard to clarify the level at which the risk adjustment is determined by a subsidiary that is part of a group of entities, as this was likely to unduly disrupt ongoing implementation given that the Board was aware that there were various views being taken in practice.

15. During the May 2018 IFRS 17 TRG discussions it was observed that some stakeholders interpreted the level at which the risk adjustment is determined at the level of the entity that is issuing the contract, and that the risk adjustment does not change in the consolidated group that includes the issuing entity. Hence, it is the compensation the entity issuing the contract requires for bearing that risk. Other stakeholders interpreted that it is the reporting entity that should determine its compensation for bearing non-financial risk, which may be different from the issuing entity.

16. One Board member had difficulty in accepting this different interpretation, noting that pricing does not change at different levels within the group, and that in order to trigger consistent reporting this requirement should be clarified. The analysis prepared by the staff notes that differences in the risk adjustment are nonetheless expected to be limited to insurance contracts accounted for applying the PAA. It was agreed that a group of entities must apply the requirements in IFRS 17 consistently across all groups of insurance contracts that it issues and observed that entities are required to disclose the confidence interval of the risk adjustment.

Subjectivity in the determination of discount rates and risk adjustment

17. All board members agreed not to amend IFRS 17 to prescribe the discount rates used to measure insurance contracts or to limit the number of risk adjustment techniques that an entity can use.

18. Some stakeholders, including regulators, have expressed concern that the principle based approach for determination of discount rates and risk adjustment for non-financial risk could reduce comparability between entities.

19. The Board observed that both discount rates and risk adjustments are entity specific, that all entities are required to meet the measurements objective, and that this would provide comparability between entities without imposing uniformity. Entities are required to disclose how they determine their discount rates and risk adjustment.

OCI option for insurance finance income or expenses

20. The Board unanimously agreed not to amend IFRS 17 to remove the OCI option, noting that whilst elimination of the option would increase comparability, it would unduly disrupt implementation already under way.

21. Many users of financial statements have expressed concerns over the option to present insurance finance income or expenses either in profit or loss or disaggregated between profit or loss and OCI, noting that this could impair comparability between entities. Several board members noted that IFRS 17 provides disclosure requirements that allow users to adjust information reported by entities to make them more comparable.

Variable fee approach ('VFA')

Definition of an insurance contract with direct participation features

22. The Board agreed not to amend the definition of an insurance contract with direct participation features.

23. The Board observed that some stakeholders consider the definition of VFA to be too narrow in scope. These stakeholders are concerned that contracts with similar economic characteristics, for example indirect participating contracts that provide significant investment related services, will be measured differently from VFA contracts.

24. The Board noted that they carefully designed the scope of VFA during the development of IFRS 17 considering the feedback received from stakeholders. The Board observed that the VFA measurement is designed to provide a faithful representation of contracts that meet the definition of insurance contracts with direct participation features. Such contracts are comparable to an asset management service provided in exchange for a fee that depends on the return on the underlying items. The Board was aware that drawing the line for the scope would have consequences.

25. At a future meeting, the Board will discuss the recognition of CSM for contracts with participating features that fail the VFA scope criteria but include investment related services. The Board will also discuss whether reinsurance contracts held should be in the scope of the VFA model.

Risk mitigation exception in the VFA

26. IFRS 17 allows a choice in the treatment of the CSM in the variable fee approach to allow for some risk mitigation activities. If an entity mitigates the financial risks of insurance contracts with direct participation features using derivatives, an entity can elect to recognise the effect of some changes in those financial risks in the insurance contracts in profit or loss, instead of adjusting the CSM, thereby creating a better matching with the hedging instrument recorded in profit or loss.

27. The Board agreed to not extend the scope of the risk mitigation option, for example to situations where non-derivatives are used as the hedging instrument. The Board is working on a broader project on accounting for risk management activities. Any short term solution would likely cause significant loss of useful information relative to that which would be provided by IFRS 17. Such an amendment could also contradict the hedge accounting requirements of IFRS 9.

28. The Board did not vote on the third question raised in staff paper 2C on whether the Board should allow retrospective application of the risk mitigation option in IFRS 17. Several Board members observed that allowing retrospective application of this risk mitigation option could allow ‘cherry picking’, distorting the CSM on transition. The Board agreed that this issue should be discussed at a future meeting along with other concerns on transition relating to reporting the OCI option under the fair value approach.

Business combinations

Classification of acquired contracts as insurance contracts in a business combination

29. The Board agreed not to amend the requirements in IFRS 17 or IFRS 3 relating to the classification of contracts acquired in a business combination as insurance contracts. The concept in IFRS 3 on business combinations is that the acquirer should classify and designate all items acquired in a business combination at the acquisition date based on contractual terms, economic conditions and other pertinent factors at that date. IFRS 3 had previously provided an exception to this requirement for insurance contracts, but IFRS 17 removed that exception as of the transition date to IFRS 17.

30. Some stakeholders have argued that assessing those contracts at acquisition date instead of inception date might create differences in classification of the same contracts in different reporting levels within a group of entities, consequently adding more cost and complexity.

31. All Board members agreed that reintroducing the exemption in IFRS 3 for classification would not meet the criteria for amendments, as it would cause significant loss of useful information relative to that required by IFRS 3 and thereby increase complexity to users and reduce comparability with other transactions.

Identification of insured event for insurance contracts acquired in a business combination

32. The Board agreed not to amend the requirements of IFRS 17 relating to the determination of the insured event for insurance contracts acquired in a business combination. The IASB staff noted that transition issues relating to this topic are expected to be addressed along with other transition issues at a future meeting. The Board noted that stakeholders have expressed concerns over the differences between IFRS 17 requirements and current practice related to the treatment of insurance contracts acquired with claims in the settlement period.

33. As IFRS 17 requires an entity to identify groups of insurance contracts as if it had entered into the contracts on the acquisition date, for acquired insurance contracts that cover events that have already occurred, the insured event is the determination of the ultimate cost of those claims (i.e. coverage is for the adverse development of claims). Therefore, the entity recognises a liability for remaining coverage and recognises revenue for the insurance service provided and claims incurred as the claims are settled.

34. Stakeholders expressed concern that for contracts for which the acquiree had accounted for the contract under the PAA, and for acquirers that typically utilise the PAA, it would be unduly burdensome to require the acquirer to develop systems to apply the general model for these contracts (which would be required if the adverse development cover had expected extended period of payment).

35. One Board member expressed sympathy for the stakeholders’ concern and asked whether it would be possible to introduce a practical expedient for such transactions. Other members were opposed to this suggestion, and questioned why the insurance

industry should be different from other industries, such as banks which cope with similar challenges in business combinations (i.e. when assessing portfolios of loans acquired).

36. Some stakeholders have noted that the issue is similar to the implementation issue raised at the September 2018 TRG where an entity's obligation was to pay amounts subject to insurance risk (e.g. adverse development) after an incurred claim (e.g. a disability event that led to life contingent payments). However, Board members noted that while the original contract may consist of two insurance risks (the original insured event and the secondary risk of adverse development), the only remaining insurance risk in acquired business is the risk of adverse development and they do not think the issues are similar.

Future cash flows in the measurement of reinsurance contracts held

37. The Board agreed not to amend the requirements of IFRS 17 relating to future cash flows in the measurement of reinsurance contracts held. IFRS 17 requires that if the cedant has a substantive right to receive services from the reinsurer in respect of underlying insurance contracts it issues, the cash flows within the boundary of the reinsurance contract held include all the cash flows expected to arise from those underlying insurance contracts that are covered by the reinsurance contract. This includes the cedant's substantive right to reinsurance coverage relating to underlying contracts that are expected but have not yet been written and recorded by the cedant.

38. Some stakeholders have expressed concern with the requirement that the cedant measure the reinsurance contract held including consideration of yet to be issued direct contracts. They think the requirement is unduly complex, will create a gross up for reinsurance coverage when the direct contracts have not yet been recognised, creating a mismatch, and they think the CSM will be recognised in an inconsistent manner as compared to the direct contract CSM.

39. Some of the Board members agreed that the new requirements of IFRS 17 will be operationally more complex. However, the appendix to the staff paper and an earlier education session with the Board demonstrated that the perceived mismatches that stakeholders are concerned about, such as the gross up issue and inconsistent recognition of the CSM between the direct and reinsurance held contracts, would not occur. It was observed that IFRS 17 provides a consistent measurement model for both reinsurance contracts and insurance contracts.

40. One Board member questioned whether the examples would hold in all circumstances; for example, different interest rates potentially could lead to different balances. However, the staff paper observed that the goal of IFRS 17 was not to achieve 'mirror' accounting between the reinsurance contract held and the underlying insurance contracts issued. This approach was considered and rejected by the Board during the development of IFRS 17 because such an approach contradicts the fundamental principle that a reinsurance contract held should be accounted for in the same manner as insurance contracts issued, including reinsurance contracts issued.

41. At a future meeting the Board plans to address other issues relating to reinsurance contracts held, including concerns related to mismatches on inception when underlying contracts are onerous and the scope of VFA for reinsurance contracts held.

Treatment of accounting estimates in interim financial statements

42. The Board unanimously agreed not to change IFRS 17 requirements relating to the treatment of accounting estimates in interim financial statements.

43. IFRS 17 paragraph B137 requires entities not to change the treatment of accounting estimates made in previous interim financial statements (i.e. interim financial reports as

defined in IAS 34, *Interim Financial Reporting)* when applying IFRS 17 in subsequent interim financial statements or in the annual financial statements.

44. Stakeholders have expressed concern over the practical difficulties that may arise when applying this requirement. For example, if a subsidiary issues standalone financial statements only on an annual basis, but the results are included in the consolidated interim financial report, the standalone subsidiary's financial statements are not subject to B137, while the parent's financial statements would be, creating different measurements for different levels within the group.

45. Some stakeholders believe that the paragraph B137 requirement should be extended to other types of interim reports that are not defined elsewhere in IFRS Standards, such as monthly management reports or internal reports provided by subsidiaries to a parent. Other stakeholders think that the requirement should not be extended to other types of interim reports but should be amended so that its application is permitted but not required, thereby allowing entities to align their measurement with competitors with different interim reporting frequencies.

46. However, the Board unanimously agreed that any such amendments would add more complexity and reduce comparability between entities.

Future expected discussions

47. The Board noted that discussion on the remaining implementation challenges and concerns will continue in future Board meetings, in addition to the question postponed during this meeting.

48. In its board papers for the October Board meeting the IASB staff presented 25 identified implementation challenges. Of the remaining concerns to be discussed at a future meeting, the staff's preliminary views in the papers for the October Board meeting indicate that it might be possible to potentially amend IFRS 17 for the following issues in a way that meets the criteria for amendment:

- Acquisition cash flows for renewals outside the contract boundary
- Reinsurance contracts held: initial recognition when underlying insurance contracts are onerous
- Modified retrospective approach
- Coverage units in the general model
- Loans and other forms of credit that transfer insurance risk

49. The staff's preliminary views in the papers for the October Board meeting are that the following issues may not meet the criteria for amendment:

- Level of aggregation
- Nil OCI on FV transition approach
- Ineligibility of reinsurance held for variable fee approach
- Date of initial application of comparatives
- Optionality on transition

Next steps

50. The Board will follow due process by issuing an exposure draft, allowing an appropriate public comment period, and redeliberating responses for any proposed amendments. The expected timeframe for issuance of final amendments (including the proposed change to the effective date agreed in November), considering the due process required, could be a year.

51. In its December meeting the Board also discussed the Annual Improvements to IFRS Standards 2018 – 2020 Cycle. The related staff paper noted that given that the IASB is considering further amendments beyond the suggested annual improvements to IFRS 17

proposed in June 2018, those annual improvements were omitted from the staff paper discussing the 2018-2020 annual improvement cycle.

52. The Board has already published a short note of the meeting that is available here.

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

- In transition INT2018-06: *IASB proposes to amend the effective date of IFRS 17 and extend the temporary exemption of IFRS 9 for insurers*
- In transition INT2018-05: *IASB agrees on criteria for evaluating any potential future amendments to IFRS 17*
- In transition INT2018-04: *TRG debates more IFRS 17 implementation issues*
- In transition INT2018-03: *Amendments to IFRS 17 on the IASB Board agenda*
- 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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