Amendments to IFRS 17 Insurance Contracts
Issues Paper on the forthcoming Exposure Draft

Introduction and Objective

1 Written input was requested from EFRAG IAWG/TEG on the following topics which are expected not to be controversial:

(a) Topic 1A - Loans that transfer significant insurance risk;

(b) Topic 1B - Credit cards that provide insurance coverage;

(c) Topic 2 - Allocation of acquisition costs to expected contract renewals;

(d) Topic 3 - Simplified balance sheet presentation;

(e) Topic 4 - Extension of risk mitigation option;

(f) Topic 5A - Transition relief for business combinations;

(g) Topic 5B - Transition relief for risk mitigation – transition date and fair value approach; and

(h) Topic 6 - Annual improvements.

2 This paper provides a summary of those written responses.

3 Ten responses were received from EFRAG IAWG and nine responses were received from EFRAG TEG.

Topic 1A - Loans that transfer significant insurance risk

EFRAG IAWG responses

4 One respondent indicated that the amendment will affect their Swedish Unit-Link business.

5 One IAWG member agreed with the drafting.

EFRAG TEG responses

6 Although EFRAG TEG members agreed with the wording one EFRAG TEG member suggested to mention that the amendment is narrow in scope and therefore would not cater for those contracts in which a general loan loss coverage is provided to the policyholder as a separate contract, instead of being included in each separate contract. Economically they may be the same, but the accounting treatment may be different; an issue in the endorsement advice with regards to comparability.

7 Two EFRAG TEG members suggested that the rationale for amending IAS 39 *Financial Instruments: Recognition and Measurement* could be better articulate.

8 One EFRAG TEG member noted that reference should be made to the actual effective date in the ED of 1 January 2022 rather than the one proposed by EFRAG Secretariat.

9 One TEG member suggested some minor drafting amendments with regards to the argumentation.

Topic 1B - Credit cards that provide insurance coverage

EFRAG IAWG responses

10 Two respondents raised a concern that the use of the term credit card excludes payment cards that also have these clauses.

11 There is also a concern that in some countries the insurance element is not required by regulation and so under IFRS 9 may fail the solely payment of principal and interest - test and would therefore have to be measured at fair value through profit or loss.

12 One IAWG member agreed with the drafting.

EFRAG TEG responses

13 One respondent noted that the reference to the following wording should be removed: '*never the intention for these types of products to be captured by the standard*' as they were previously considered within the scope of IFRS 4 and the definition of insurance risk did not change in IFRS 17. The respondent noted that the wording should be replaced to rather state that the amendments avoid unnecessary costs of implementing IFRS 17 accounting policies and systems when fair value can fairly represent the insurance risks and liabilities.

14 One TEG member suggested some minor drafting amendments with regards to the argumentation.

15 One respondent suggested that paragraph 10 should be amended to delete the following: '*these products are aimed at providing coverage for credit risk rather than insurance risk*' as the coverage includes protection for the quality of the goods sold as well coverage in the case that the seller fails to deliver under its non-financial obligations with respect to the sale.

Topic 2 - Allocation of acquisition costs to expected contract renewals

EFRAG IAWG responses

16 Although respondents agreed with the proposed wording they raised the following concerns:

(a) One respondent noted that some people argue for the allocation of acquisition costs to be optional as for those who have smaller amounts this will involve extra cost. However one respondent noted that the final wording proposed in the ED should be evaluated whilst the other noted that they are supportive of the amendment either as an option or as it is currently stated.

(b) There is a potential issue with determining the deferred acquisition cost asset in respect of long-term renewable contracts on transition. In circumstances where the full retrospective approach is impracticable, the modified retrospective approach cannot be used as this approach only refers to modifications in regard to the CSM, not the deferred acquisition cost asset. This would leave the fair value approach as the only practicable approach. It is not clear what the fair value of such an asset is. Therefore it is suggested that the modified retrospective approach be further modified to allow simplifications in the calculation of the deferred acquisition cost asset.

(c) One respondent suggested that wording should be added that the allocation should only be made on renewals and not on completely new contracts for the same policyholder or new policyholder.

(d) One respondent noted that the option to expense acquisition costs under the PAA makes accounts less comparable as now the difference between expensing over one year is extended to the expected life time of the contracts.

(e) One IAWG member agreed with the drafting.

EFRAG TEG responses

17 Consistent with the comment in paragraph 16(a) one EFRAG TEG member responded that several Danish insurance companies are of the view that the amendment to IFRS 17 paragraph 27 should only be an option under the General model and the VFA and for the Premium Allocation Approach under IFRS 17 paragraph 59(a). The respondent noted that it should still be possible to amortise the costs capitalised under the existing IFRS 17 paragraph 27.

18 Another respondent indicated that whilst EFRAG recognises the risk for users to permit accounting to extend beyond the contract boundary, the main concern is about asset recoverability and clear disclosure. Consistent with paragraph 16(a) above two respondents noted that EFRAG should consider the wording in the ED.

19 One EFRAG TEG member agreed with the drafting and response.

20 One respondent noted that support could be added to the argumentation to state the proposed amendments are more closely aligned with IFRS 15.

Topic 3 - Simplified balance sheet presentation

EFRAG IAWG responses

21 Nine respondents agreed with the proposed drafting but added several comments:

(a) Four respondents questioned the usefulness of the separate presentation of portfolios that are in an asset or liability position for different reasons.

(i) It does not provide useful information to users; and

(ii) It is not conceptually correct.

22 Four respondents noted that the issue of receivables/payables was not resolved yet. One of them noted that putting together receivables and liabilities together does not result in a fair representation as a very low liability will give the notion of very low insurance obligations, when it's merely related to cash flow timing differences. One of those respondents also added another presentation that remained unresolved: the treatment of deposits retained.

23 One observer questioned the relevance of the first sentence: "EFRAG considers information about separate assets and liabilities as required under IAS 1 *Presentation of Financial Statements* provides useful information". He noted that the issue of "compensation" only arise if one assumes that the individual contract is the appropriate unit of account for measurement purpose. Then it makes sense not to allow offsetting one contract with another. However, in the case of insurance contracts, the IASB itself recognized that using individual contract as a unit of account "does not provide useful information about insurance activities", because "insurance activities often rely on an entity issuing a number of similar contracts to reduce risks". As a consequence, prohibiting offsetting between individual contracts when this unit of account does not provide useful information does not make sense.

24 Furthermore, as the main objective of paragraph 33 of IAS 1 (for prohibiting compensation) is to enable users of financial statements to assess the entity's future cash flows, it makes sense to present insurance contract at the (higher) level of aggregation used to estimate the expected future cash flows.

25 Paragraph 33 of IAS 1 highlight that the prohibition to offset assets and liabilities is designed to provide users with information about transactions and events and to enable them to assess the entity's future cash flows.

26 On the other hand, the IFRS 17 definition of groups aims at :

(a) Recognizing losses on onerous contracts;

(b) Recognizing revenues in the appropriate period.

(c) As a consequence, in his view the group of insurance contract is not designed to meet the objectives of paragraph 33 of IAS 1 and therefore not a relevant unit of account for the presentation of the balance sheet.

EFRAG TEG responses

27 Five respondents agreed with the proposed drafting and added the following comments:

(a) The portfolio level does not reflect pricing decisions that are more evident at group level;

(b) There is no conceptual basis for the amendment, but it is supported on cost/benefit grounds;

(c) The answer on topic 3 should discuss (or refer to such a discussion elsewhere in the DCL) on the basis of why the presentation requirements should differ from those in IFRS 15 *Revenue from Contracts with Customers*.

(d) Paragraph 20 should better articulate by more precise reference to what is meant by referring to IAS 1 *Presentation of Financial Statements.*

(e) In the second sentence of paragraph 20 it should be clarified whether this referred to disclosures, presentation or both. This sentence could be put in the notes to constituents.

(f) Paragraph 21, the reference to offsetting was not considered helpful for the argumentation. Another respondent suggested to remove paragraph 21 entirely.

(g) It was suggested to remove the word “significantly” from EFRAG’s response (but leave to users the opportunity to evidence that an asset/liability presentation at a lower level actually provides useful information).

(h) It was suggested to introduce a reference to the other B/S presentation issue relating to the separate presentation of accruals, that will be addressed separately.

28 One respondent asked whether a question to constituents was necessary in order to clarify whether a presentation simplification should be supported on cost/benefit grounds while shortcutting measurement principles.

Topic 4 - Extension of risk mitigation option

EFRAG IAWG responses

29 One auditor and two members agreed with the proposed wording/IASB decision. However, one of them suggested to provide feedback to the IASB on responses from EFRAG’s questionnaire on hedge accounting as companies, under IAS 39, hedge different risk components not only with derivatives and reinsurance contracts. It was mentioned by this member that a mix between fixed rate and variable rate instruments together with swaps, options and IRS may be used.

30 Four members supported the extension but indicated that they did not go far enough and the scope should be widened:

(a) Risk mitigation strategies can use combinations of derivatives and other securities. (for example, hedging of interest rate risk is often carried out using a combination of swaps, swaptions and fixed interest securities.

(b) It does not address the case of reinsurance assumed that cannot apply the VFA even though they meet the VFA criteria. The risk mitigation option should be extended to indirect participating contracts for which derivatives are used to cover guaranteed interest rates.

(c) For UK unit-linked business a unit-shorting technique is used. This member proposes to widen the scope to all risk mitigation activity which is undertaken using financial instruments which are classified as fair value through profit or loss. They mentioned also that they do not foresee widespread application of the risk mitigation option.

(d) The scope should be extended to when derivatives hedge financial risks or non-financial risks of contracts not eligible for VFA.

31 One auditor stated that it was unclear why the extension to reinsurance did not also include other financial instruments. However, this member did not hear that this was an issue in practice.

EFRAG TEG responses

32 Three members supported the extension of the risk mitigation. One of these members specified that he did not support requesting for further relief.

33 Another member supported the extension of the risk mitigation but had two significant concerns:

(a) The solution excludes non-derivative financial instruments; and

(b) No risk mitigation solution is available for the general model within IFRS 17:

(i) Use of OCI results in an accounting mismatch;

(ii) Partial hedging is not encouraged, and even a FVPL approach frequently results in significant volatility;

(iii) It is unclear whether the IAS 39 general hedge accounting requirements can be applied to many types of insurance liabilities;

(iv) IFRS 9 hedge accounting does not produce the intended effect for all types of risk that the industry is hedging and does not accommodate macro hedging approaches; and

(v) It is unclear whether the macro hedging project will address the issues and it may take several years.

34 One member indicated that the notes to constituents should include the reasons for the accounting mismatch and he supported an argument that VFA should not be permitted for reinsurance where it, in itself, does not meet the VFA criteria, even of the underlying insurance contract is under VFA.

35 Another member agreed with the extension but wanted it further extended to address risk mitigation for non-VFA contracts and the application of risk mitigation to risks other than financial ones. This member stated that the solution should not preclude a retrospective application. In addition, the risk mitigation is not a solution to fix the VFA prohibition for reinsurance issued.

36 One member stated that it would be preferable with retrospective application of the risk mitigation relief for variable fee contracts in case entities are able to prove using reasonable and supportable information that a hedging strategy was in place before application of IFRS 17. But he noted this also raised questions about hindsight. Therefore, on balance, he believed the IASB proposal is acceptable and in line with other transition rules in other IFRSs.

37 One member questioned about retrospective application of the amendments.

Topic 5A - Transition relief for business combinations

EFRAG IAWG responses

38 Seven members agreed with the IASB tentative decisions for transition. However, three of them indicated that a solution for the same issue of the business combinations going forward would be needed.

39 Two members indicated that the decisions should be extended to the full retrospective approach and permitted even if it is practicable to apply the standard without relief.

(a) Even if the data can be gathered, the restatement will represent a considerable workload. The related additional costs are expected to be disproportionate to the potential added value (if any).

40 One observer suggested some editorial changes to the drafting in order to be consistent with the IASB staff paper on the operational complexity to distinguish:

(a) contracts that the entity issued;

(b) contracts that the entity acquired - that occurred before the transaction date;

(c) contracts that the entity acquired – that occurred after the transaction date.

EFRAG TEG responses

41 Two members agreed with the proposed wording.

42 Two members agreed with the transition relief but questioned why it was not available to the full retrospective approach.

43 One member stated that the scope and nature of the relief should be fully explained, and we should state that we support the IASB not to give more extensive relief.

44 Another member supported the transition relief but wanted to retain something similar to the existing exception in IFRS 3 or to make a simplification for liabilities for incurred claims in the business combinations after transition. He wondered whether a similar process should be followed for other liabilities (such as dismantling) acquired in a business combination. He did not understand why a CSM is not recognised on such a liability.

45 One member stated that the justification mentioned would equally apply beyond transition. He suggested to rephrase the justification on the basis of practicality.

Topic 5B - Transition relief for risk mitigation – transition date and fair value approach

EFRAG IAWG responses

46 Four respondents agreed with the proposed drafting, three of them added a retrospective application of the risk mitigation option would be preferable. One of the respondents noted that the proposed reliefs should be better articulated in the letter.

47 Three respondents disagreed and noted the following comments:

(a) The IASB is willing to change the proposed accounting;

(b) Developing another solution will not take much time as the CFO Forum has developed it already;

(c) The relief should be applicable to all approaches at transition.

48 One observer noted that it should be explained why there is a risk of hindsight. In his view the risk of hindsight does not stem from applying risk mitigation retrospectively but from the fact that it is an option.

49 On the fair value approach, one respondent noted that it would help entities applying risk mitigation strategies to reflect a more appropriate overall impact on equity when transitioning to IFRS 17.

EFRAG TEG responses

50 Three respondents agreed with the proposed drafting, its general direction or as a balanced outcome.

51 Three respondents preferred a retrospective application of the risk mitigation option. These respondents noted the following:

(a) The IASB is open to re-discuss the issue;

(b) It was preferred on rules mitigating the risk of hindsight rather than not allowing to represent previous applied hedging strategies;

(c) The argument that another solution is complex to develop is not supported as B115 can be applied;

(d) The arguments put forward do not align with the use of reasonable and supportable information;

52 One respondent did not support the arguments provided in the third paragraph in the box (and in paragraphs 37-38) to justify the prohibition of retrospective application if the risk mitigation was in place and documented prior to transition.

Topic 6 - Annual improvements

EFRAG IAWG responses

53 Three members agreed with the proposed wording.

54 Four members and one observer were concerned about the annual improvement relating to amending paragraph B128 of IFRS 17. This change is to clarify that changes in the measurement of a group of insurance contracts caused by changes in underlying items should be treated as changes in investments and hence as changes related to the time value of money or assumptions that relate to financial risk.

(a) It is a question of presentation without impact on the net income: the proposed amendment is likely to alter the understanding of the accounts as the financial result will include items that are not financial. There would be a mispresentation between insurance service result and finance result requiring to present items that are not financial (e.g. experience on claims in case the policyholders share on the insurance result) in the financial result. One of the members provided an example which is in the Appendix to this paper.

(b) Amending paragraph B128 of IFRS 17 does not represent the underlying economics.

(c) Knock-on consequences of the proposed amendments on the presentation of contracts accounted for under the variable fee approach should be considered.

55 One member noted the following annual improvements had adverse consequences:

(a) Whilst changes to paragraph 28 of IFRS 17 to achieve the intended timing of recognition of contracts within a group usefully clarifies when contracts are to

be recognised, the requirement to allocate contracts to groups based on issue date is operationally onerous.

(b) Clarifying the definition of an investment component (as the amount that an insurance contract requires an entity to repay in all circumstances) would seem to severely restrict investment components – such that they are not present even on contracts where claims commonly occur other than on occurrence of the insured event. An example provided was a regular premium whole of life contract, with premiums payable for 20 years, and no surrender value (or paid up option) available for the first two years. There wouldn't seem to be an investment component under the new definition given that if a policyholder stops paying premiums in the first two years, they get nothing back.

56 One member supported the amendments to paragraph 28 of IFRS 17 which refers to recognition date. However, they did not agree with the IASB decision not to amend the terminology in paragraph 22 of IFRS 17[1]. The level of aggregation is relevant once the contract is recognised. Using the issue date instead of the recognition date for the grouping would have implications on e.g. the discount rate and difficulties in terms of data availability causing severe operational issues and undue costs.

EFRAG TEG responses

57 Two members agreed with the proposed wording.

58 Three members could not conclude at the moment as further analysis was needed. One of these members indicated that the paper should explain the rationales for the changes. Another member stated that the arguments should focus on providing clarity, where applicable, or corrections rather than providing useful information.

59 One member suggested that the minor amendments be discussed more in detail in order to ensure that they do not have any unintended consequences.

[1] IFRS 17.22 states that "*an entity shall not include contracts issued more than one year apart in the same group*".

Appendix: Topic 6 – Annual Improvements

Example provided by an EFRAG IAWG member relating to the amendment of paragraph B128 of IFRS 17

1. Policyholder participates in 80% of investment result, 50% of expense result, 50% of insurance result
2. Expected claim: 100
3. Actual claim: 150
4. Investment income: 60
5. Interest accretion on insurance liabilities: 30
6. Other cash flows and the discounting effect ignored for simplification
7. 50% of the experience variance on claims (i.e., 25) will reduce future payments to policyholders. With the proposed amendments, these changes in dividend cash flows are treated as changes in financial assumptions. They are therefore recognised in the investment result. The experience variance itself, however, is part of the insurance service result. As a result, the presentation of the sources from which the profits are generated is heavily distorted:

Insurance service result:	
- Expected claims	100
- Actual claims	-150
	-50
Investment result:	
- Investment income	60
- Insurance finance expenses	-30
- Change in financial risk (from changes in dividend cash flows due to changes in expected claims)	25
	55
Net income	**5**