June 2019

IFRS® Standards Exposure Draft ED/2019/4
Basis for Conclusions

Amendments to IFRS 17

Comments to be received by 25 September 2019

IASB®

Basis for Conclusions on Exposure Draft
Amendments to IFRS 17

This Basis for Conclusions accompanies the Exposure Draft ED/2019/4 *Amendments to IFRS 17* (issued June 2019; see separate booklet) and is published by the International Accounting Standards Board (Board).

Disclaimer: To the extent permitted by applicable law, the Board and the IFRS Foundation (Foundation) expressly disclaim all liability howsoever arising from this publication or any translation thereof whether in contract, tort or otherwise to any person in respect of any claims or losses of any nature including direct, indirect, incidental or consequential loss, punitive damages, penalties or costs.

Information contained in this publication does not constitute advice and should not be substituted for the services of an appropriately qualified professional.

ISBN for this part: 978-1-911629-34-4

ISBN for complete publication (two parts): 978-1-911629-32-0

Copyright © 2019 IFRS Foundation

All rights reserved. Reproduction and use rights are strictly limited. Please contact the Foundation for further details at licences@ifrs.org.

Copies of Board publications may be obtained from the Foundation's Publications Department. Please address publication and copyright matters to publications@ifrs.org or visit our webshop at http://shop.ifrs.org.

The Foundation has trade marks registered around the world (Marks) including 'IAS®', 'IASB®', the 'IASB® logo', 'IFRIC®', 'IFRS®', the IFRS® logo, '*IFRS for SMEs*®', the *IFRS for SMEs*® logo, the 'Hexagon Device', 'International Accounting Standards®', 'International Financial Reporting Standards®', 'IFRS Taxonomy®' and 'SIC®'. Further details of the Foundation's Marks are available from the Foundation on request.

The Foundation is a not-for-profit corporation under the General Corporation Law of the State of Delaware, USA and operates in England and Wales as an overseas company (Company number: FC023235) with its principal office in the Columbus Building, 7 Westferry Circus, Canary Wharf, London, E14 4HD.

CONTENTS

from paragraph

BASIS FOR CONCLUSIONS ON EXPOSURE DRAFT *AMENDMENTS TO IFRS 17*

INTRODUCTION BC1

BACKGROUND BC4

AREAS IN WHICH THE BOARD PROPOSES AMENDMENTS TO IFRS 17

Scope exclusions—credit card contracts and loan contracts that meet the definition of an insurance contract BC9

Expected recovery of insurance acquisition cash flows BC31

Contractual service margin attributable to investment-return service and investment-related service BC50

Reinsurance contracts held—recovery of losses on underlying insurance contracts BC67

Presentation in the statement of financial position BC91

Applicability of the risk mitigation option BC101

Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4 BC110

Transition modifications and reliefs BC119

Minor amendments BC147

AREAS THE BOARD CONSIDERED AND FOR WHICH AMENDMENTS TO IFRS 17 ARE NOT PROPOSED

Level of aggregation BC164

Cash flows in the boundary of a reinsurance contract held BC180

Subjectivity in the determination of discount rates and the risk adjustment for non-financial risk BC186

Risk adjustment for non-financial risk in a consolidated group of entities BC189

Discount rate used to determine adjustments to the contractual service margin BC193

Other comprehensive income option for insurance finance income or expenses BC200

Business combinations BC203

Scope of the variable fee approach BC209

Interim financial statements BC214

Mutual entities issuing insurance contracts BC217

EFFECTS ANALYSIS BC221

© IFRS Foundation

Basis for Conclusions on Exposure Draft *Amendments to IFRS 17*

Introduction

BC1 IFRS 17 *Insurance Contracts* establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts. IFRS 17 was issued in May 2017 with mandatory application for annual reporting periods beginning on or after 1 January 2021. IFRS 17 replaces IFRS 4 *Insurance Contracts*, an interim Standard that allowed entities to use a wide variety of accounting practices for insurance contracts.

BC2 This Basis for Conclusions explains the Board's rationale for the amendments to IFRS 17 proposed in the Exposure Draft in response to concerns and challenges identified by entities implementing IFRS 17. To provide the context for the Board's decision to publish the Exposure Draft, this Basis for Conclusions also explains the Board's rationale for the amendments suggested by some stakeholders that the Board considered and decided not to propose.

BC3 IFRS 17 was developed after extensive engagement with stakeholders. During this period, diverse national practices continued, and in some cases became increasingly out-of-date. The Board considers it urgent that IFRS 17 is adopted. Accordingly, when the Board assesses the feedback on the Exposure Draft, it does not intend to revisit suggestions it has previously rejected or consequences it has previously considered.

Background

BC4 The Board recognises that IFRS 17 introduces fundamental changes and that implementing the new accounting requirements involves significant operational costs, including system development costs.

BC5 Consequently, since IFRS 17 was issued, the Board has been carrying out activities to support and monitor entities' progress in implementing the Standard. These activities include establishing the Transition Resource Group for IFRS 17 to discuss implementation questions, and meeting with stakeholders affected by the changes introduced by IFRS 17, including preparers and users of financial statements, auditors, and regulators.

BC6 These activities have enabled entities to better understand the new requirements and to prepare for the application of IFRS 17. They have also helped the Board to understand the concerns and challenges some entities have identified while implementing the Standard.

BC7 The Board considered the concerns and challenges raised and concluded that the potential costs of proposing targeted amendments to IFRS 17 could be justified if those amendments would:

 © IFRS Foundation

(a) provide meaningful support to entities implementing the Standard, by reducing implementation costs and making it easier for entities to explain the results of applying IFRS 17 to users of financial statements; and

(b) not result in a significant loss of useful information for users of financial statements relative to that which would otherwise result from applying IFRS 17.

BC8 To maintain the benefits of IFRS 17, the Board decided that any amendments to IFRS 17 must not:

(a) 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;

(b) unduly disrupt implementation already underway; or

(c) further delay the effective date of IFRS 17.

Areas in which the Board proposes amendments to IFRS 17

Scope exclusions—credit card contracts and loan contracts that meet the definition of an insurance contract (paragraphs 7(h) and 8A and Appendix D)

Proposed amendments

BC9 IFRS 17 applies to all contracts that transfer significant insurance risk, regardless of the type of entity issuing the contracts, with some specific scope exclusions. The Board has been made aware that some credit card contracts and loan contracts transfer significant insurance risk and, consequently, are within the scope of IFRS 17. Examples are:

(a) credit card contracts that provide insurance coverage for purchases made using the card; and

(b) loan contracts such as a loan contract with a death waiver and a lifetime mortgage with a no-negative-equity-guarantee.

BC10 The Exposure Draft proposes two additional scope exclusions to the requirements in IFRS 17:

(a) paragraph 7(h) proposes that credit card contracts that meet the definition of an insurance contract be excluded from the scope of IFRS 17 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.

(b) paragraph 8A proposes that an entity may choose to apply IFRS 9 *Financial Instruments* instead of IFRS 17 to contracts that meet the definition of an insurance contract but that limit the compensation for insured events to the amount required to settle the policyholder's

obligation created by the contract (for example, loan contracts with death waivers). The entity would be required to make that choice for each portfolio of insurance contracts and the choice for each portfolio would be irrevocable.

BC11 The Board decided it would not be necessary to propose additional disclosure requirements in IFRS 17 or IFRS 9 related to the proposed amendments in paragraphs 7(h) and 8A of the Exposure Draft (other than on transition in some circumstances, see paragraph BC30(b)). Both IFRS 17 and IFRS 9 already specify sufficient disclosure requirements for such contracts.

Rationale for changing the requirements

BC12 The definition of an insurance contract in IFRS 17 is unchanged from IFRS 4, and so the contracts described in paragraph BC9 already meet the definition of an insurance contract applying IFRS 4. However, IFRS 4 permits an entity to separate from a host insurance contract some non-insurance components and apply other IFRS Standards to the non-insurance components. IFRS 4 also allows a wide range of accounting practices for components that are not separated. As a result, some entities may be applying IFRS 9 or IAS 39 *Financial Instruments: Recognition and Measurement*, or an accounting policy similar to the requirements in those Standards, to such contracts. IFRS 17 is more restrictive on the separation of non-insurance components and is more specific in its requirements for accounting for all aspects of insurance contracts in their entirety. The Board was persuaded that for some entities that apply accounting policies consistent with IFRS 9 or IAS 39 to some credit card contracts and loan contracts that transfer significant insurance risk, the costs of applying IFRS 17 might exceed the benefits of changing to applying IFRS 17, as described in paragraphs BC13–BC22.

Proposed amendment to exclude from the scope of IFRS 17 specified credit card contracts that meet the definition of an insurance contract (paragraph 7(h))

BC13 Some credit card contracts meet the definition of an insurance contract because the entity issuing the contracts provides insurance coverage as part of the overall package of benefits provided to the customer. An entity might provide such insurance coverage either because it is obliged to do so (for example, because of law or regulation), or because it chooses to do so (for example, as a fixed-price 'add-on'). If the entity acts as an agent in providing insurance coverage under such a contract, the contract is not an insurance contract issued by the entity. However, if the entity provides insurance coverage as a principal, the contract is an insurance contract issued by the entity.

BC14 The Board considered whether an entity should apply IFRS 17 to such insurance contracts. IFRS 9 and IFRS 17 both have requirements that can address credit risk and insurance risk, which are prominent features of such credit cards. IFRS 9 is more focused on credit risk and IFRS 17 is more focused on insurance risk. The Board noted there is a balance between the usefulness of the information about such contracts that would be provided by

 © IFRS Foundation

applying IFRS 9 and the usefulness of the information about such contracts that would be provided by applying IFRS 17.

BC15 When an entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer, the Board concluded that IFRS 9 would provide more useful information about those contracts. When the entity does reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer, the Board concluded that IFRS 17 would provide more useful information about those contracts. Hence, the Board decided that the Standard to be applied should not be a matter of choice. Furthermore, the Board has not been made aware of entities applying insurance contract accounting practices today to credit card contracts for which the entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer.

BC16 Accordingly, the Board proposes a specific scope exclusion to reduce the operational burden for entities issuing credit card contracts for which the entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer. Doing so would address specific stakeholder concerns that some entities will need to implement and manage processes and systems for IFRS 17 only because they issue such credit card contracts. Excluding such contracts from the scope of IFRS 17 for these reasons would be similar to the rationale for providing the existing scope exclusion in paragraph 8 of IFRS 17 for fixed-fee service contracts. One of the criteria for the scope exclusion in paragraph 8 of IFRS 17 is that the entity does not reflect an assessment of the insurance risk associated with an individual customer when setting the price of the contract with that customer.

BC17 The Board considered whether it should limit the scope of the exclusion to credit card contracts with insurance coverage that the entity is obliged to provide (for example, because of law or regulation). However, the Board saw no reason to distinguish between the credit card contracts described in paragraph BC13 depending on whether the entity is obliged, or chooses, to provide insurance coverage.

Proposed amendment to permit an entity to apply IFRS 9, instead of IFRS 17, to specified contracts that meet the definition of an insurance contract (paragraph 8A)

BC18 Some contracts meet the definition of an insurance contract but limit the compensation for insured events to the amount required to settle the policyholder's obligation created by the contract (for example, loan contracts with death waivers). An entity would provide useful information about such contracts applying either IFRS 17 or IFRS 9. Both credit risk and insurance risk are prominent features in such contracts and, as noted in paragraph BC14, both Standards have requirements that can address these risks, albeit with a different focus.

BC19 Hence, the Board concluded:

(a) requiring an entity to apply IFRS 17 to those contracts, when the entity had previously been applying an accounting policy consistent with IFRS 9 or IAS 39 to those contracts (or vice versa), could impose cost without a corresponding benefit; and

(b) more useful information for users of financial statements might be provided if an entity were to apply the same Standard to those contracts as it applies to other similar contracts it issues.

BC20 Accordingly, the Board concluded that, for such contracts, an entity would be required to make the choice between applying IFRS 17 or IFRS 9 for each portfolio of insurance contracts and the choice for each portfolio would be irrevocable.

BC21 The Board considered whether the proposed amendment in paragraph 8A of the Exposure Draft should be applied on a contract-by-contract basis, rather than on a portfolio of insurance contracts basis. Requiring a contract-by-contract basis would be consistent with the scope exclusion for fixed-fee service contracts in paragraph 8 of IFRS 17. However, the Board concluded that applying the proposed amendment in paragraph 8A of the Exposure Draft on a portfolio basis would mitigate the lack of comparability that might otherwise arise between similar contracts issued by the same entity, and between similar contracts issued by different entities.

BC22 The Board considered a suggestion that IFRS 17 be amended to require an entity to separate a loan component from such an insurance contract, consistent with existing accounting practice for some contracts. However, the Board confirmed the approach in paragraphs 10–13 of IFRS 17—that components of a contract should not be separated if they are highly interrelated. As explained in paragraph BC10(a) of the Basis for Conclusions on IFRS 17, it would be difficult for an entity to separate such components routinely, and setting requirements to do so would result in complexity. Such separation would also ignore interdependencies between components, with the result that the sum of the values of the components may not always equal the value of the contract as a whole, even on initial recognition.

Transition requirements when an entity chooses to apply IFRS 9 to contracts specified in paragraph 8A (Appendix D)

BC23 Entities that do not apply the temporary exemption in IFRS 4 are required to apply IFRS 9 (as issued in 2014) for annual periods beginning on or after 1 January 2018. Accordingly, some entities will apply the amended IFRS 17 after they have already applied IFRS 9.

BC24 The Exposure Draft proposes transition requirements for such entities that choose, applying paragraph 8A of the Exposure Draft, to apply IFRS 9 to insurance contracts that limit the compensation for insured events to the amount required to settle the policyholder's obligation created by the contract.

 © IFRS Foundation

BC25 Without those proposed requirements in the Exposure Draft, the transition requirements in Section 7.2 of IFRS 9 (as issued in 2014) would not be applicable for entities that have already applied IFRS 9. Accordingly, an entity would be required to apply the proposed amendments in the Exposure Draft retrospectively applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

BC26 Retrospective application in such circumstances would be consistent with the general requirement that an entity applies the classification and measurement requirements in IFRS 9 retrospectively. However, in some circumstances, an entity may not be able to apply the proposed amendments in the Exposure Draft retrospectively without the use of hindsight.

BC27 When the Board developed the transition requirements in IFRS 9, it provided requirements to address scenarios in which it would be impracticable for entities to apply particular requirements retrospectively. The Board expects that similar scenarios might arise when an entity first applies IFRS 9 to contracts addressed by paragraph 8A of the Exposure Draft. Accordingly, the Exposure Draft proposes that an entity would apply the relevant transition requirements in IFRS 9 that are necessary to initially apply the proposed amendment in paragraph 8A of the Exposure Draft.

BC28 The Board also considered specific transition requirements related to the fair value option in IFRS 9. An entity's decision to apply IFRS 9 to insurance contracts that limit the compensation for insured events to the amount required to settle the policyholder's obligation created by the contract could change, either partially or in full, the classification and measurement of such contracts. Such changes may create or eliminate accounting mismatches between the contracts and financial liabilities an entity might consider to be related to the contracts. Therefore, the Board decided to propose amendments to the IFRS 9 transition requirements that would permit an entity to designate, or that would require an entity to revoke its previous designation of, a financial liability at the date of initial application of the proposed amendments to the extent that a new accounting mismatch is created, or a previous accounting mismatch no longer exists, as a result of applying the proposed amendment in paragraph 8A of the Exposure Draft.

BC29 The Board noted that paragraph C29 of IFRS 17 already permits an entity to designate a financial asset and requires an entity to revoke its previous designation of a financial asset at the date of initial application of IFRS 17. In addition, paragraphs C32–C33 of IFRS 17 require disclosures about those assets. Accordingly, the Board decided it is unnecessary to propose further requirements for the designation or de-designation of financial assets under the fair value option in IFRS 9.

BC30 The Exposure Draft also proposes the following amendments for consistency with the transition requirements in IFRS 9 and IFRS 17:

(a) an entity would not be required to restate prior periods to reflect the effect of the proposed amendments, and could choose to do so only if such restatement is possible without the use of hindsight and if the restated financial statements reflect all the requirements in IFRS 9 for the affected financial instruments;

(b) an entity would disclose, in addition to any disclosures required by other IFRS Standards, information about the changes in the classification and measurement of contracts as a result of applying the proposed amendments in paragraph 8A of the Exposure Draft; and

(c) an entity would not be required to disclose, for the current period or any prior period presented, the quantitative information otherwise required by paragraph 28(f) of IAS 8.

Expected recovery of insurance acquisition cash flows (paragraphs 28A–28D, 105A–105C and B35A–B35C)

Proposed amendment

BC31 Appendix A of IFRS 17 defines insurance acquisition cash flows as cash flows arising from the costs of selling, underwriting and starting a group of insurance contracts that are directly attributable to the portfolio of insurance contracts to which the group belongs. Such cash flows include cash flows that are not directly attributable to individual contracts or groups of insurance contracts within the portfolio. Paragraph 27 of IFRS 17 (paragraph 28B(b) of the Exposure Draft) requires an entity to recognise an asset for any insurance acquisition cash flows relating to a group of insurance contracts that are paid before the group is recognised. The Exposure Draft proposes an amendment to the definition of insurance acquisition cash flows in Appendix A of IFRS 17 to clarify that insurance acquisition cash flows relate to groups of insurance contracts issued or expected to be issued. Cash flows paid before a related group of reinsurance contracts held are recognised are addressed in paragraph 65(a) of IFRS 17.

BC32 The Exposure Draft proposes that an entity would be required to:

(a) allocate, on a systematic and rational basis, insurance acquisition cash flows that are directly attributable to a group of insurance contracts to that group and to groups that include contracts that are expected to arise from renewals of the contracts in that group;

(b) recognise as an asset insurance acquisition cash flows paid before the group of insurance contracts to which they are allocated is recognised; and

(c) assess the recoverability of any asset for insurance acquisition cash flows if facts and circumstances indicate the asset may be impaired.

BC33 The Exposure Draft also proposes that an entity would be required to disclose:

(a) a reconciliation from the opening to the closing balance of any asset for insurance acquisition cash flows; and

 © IFRS Foundation

(b) quantitative information about when the entity expects to derecognise an asset for insurance acquisition cash flows.

Rationale for changing the requirements

BC34 The following example illustrates the concern raised by stakeholders.

BC35 An entity pays commissions to an agent for selling insurance contracts on its behalf and those commissions meet the definition of insurance acquisition cash flows. The commissions:

(a) relate directly to the insurance contracts sold by the agent;

(b) are due to be paid to the agent on the sale of those contracts; and

(c) are non-refundable irrespective of whether those contracts are renewed.

BC36 The amount of the commissions is higher than the premiums of the insurance contracts issued. However, the entity agrees to pay the commissions because it expects that some policyholders will renew contracts, possibly many times. In this example, applying paragraph 34 of IFRS 17, cash flows related to expected renewals of contracts are outside the boundary of the original contracts. As a result, the full amount of the commissions would be included in the measurement of the groups that include the insurance contracts sold by the agent and, consequently, a loss would be recognised on initial recognition of those groups.

BC37 In the Board's view, the requirements in IFRS 17 for insurance acquisition cash flows provide useful information about the example in paragraphs BC35–BC36 because those requirements reflect the entity's rights that result from the payment of commissions. In the example, recognising a loss for the insurance contracts sold by the agent reflects that the entity has paid commissions to the agent for selling those contracts and has no right to a refund if the policyholders do not renew the contracts.

BC38 In contrast to the example in paragraphs BC35–BC36, if the contract with the agent provided the entity with a right to a refund in the event of the insurance contracts not being renewed, the commissions would not be directly attributable to the initial contract and the entity would allocate the commissions on a systematic and rational basis, which could include allocating some of the commissions to the expected renewals of contracts.

BC39 The Board was persuaded that an amendment to IFRS 17 so that an entity allocates insurance acquisition cash flows to expected renewals of contracts would also provide useful information to users of financial statements about insurance acquisition cash flows. Some stakeholders stated that the contracts described in the example in paragraphs BC35–BC36 are not onerous because the commissions have been paid in expectation that the entity will be able to recover the commissions in the future through renewals of those contracts. Those stakeholders also noted that the requirements in IFRS 17 for the allocation of insurance acquisition cash flows differ from the requirements in IFRS 15 *Revenue from Contracts with Customers* for incremental costs of obtaining a contract, which requires an entity to amortise an asset recognised for such

costs based on the pattern of transfer of goods and services, including the transfer of goods and services under specifically anticipated (ie future) contracts. The Board was persuaded that the payment of the commissions creates an asset that may be expected to be recovered through expected renewals of contracts. The resulting information would also be comparable to the information provided by IFRS 15 for the incremental costs of obtaining a contract.

BC40 The Board considered whether it should develop requirements to specify how to allocate insurance acquisition cash flows to expected renewals of contracts. However, it decided that requiring allocation on a systematic and rational basis, consistent with paragraph B65(l) of IFRS 17, would be sufficient. In the Board's view, adding further requirements would risk adding complexity for both preparers and users of financial statements, and might result in a rules-based approach that would achieve an outcome that is appropriate only in some circumstances.

BC41 Paragraph 27 of IFRS 17 (paragraph 28B(b) of the Exposure Draft) already requires the recognition of an asset for insurance acquisition cash flows that the entity pays before they are included in the measurement of a group of insurance contracts. The Board observed that when an entity issues contracts it expects will be renewed, the proposed amendment in paragraph B35A(b) of the Exposure Draft would extend the period for which such an asset exists and could increase the amount of the asset. IFRS 17 does not specify whether an entity should accrete interest on an asset recognised applying paragraph 27 of IFRS 17 and, if so, at what discount rate. The Board considered whether it should specify requirements for accretion of interest in the light of the potential extension and increase in amount of the asset resulting from the proposed amendment. The Board decided not to do so because to do so would be inconsistent with IFRS 15, which does not specify requirements for accretion of interest on assets recognised applying paragraph 91 or 95 of that Standard.

Proposed impairment test

BC42 IFRS 17 does not require an entity to assess the recoverability of assets recognised applying paragraph 27 of IFRS 17 because the asset is typically of relatively short duration and any lack of recoverability will be reflected on a timely basis when those assets are derecognised and the insurance acquisition cash flows are included in the measurement of a group of insurance contracts. As explained in paragraph BC41, the proposed amendment in paragraph B35A(b) of the Exposure Draft could extend the period for which an asset recognised applying paragraph 27 of IFRS 17 exists and could increase the amount of the asset. The period for which the asset is recognised would also rely on an assessment of expected renewals of contracts, beyond those considered applying the existing requirements in IFRS 17. Accordingly, the Board concluded it would be appropriate to require an entity to assess the recoverability of an asset recognised applying paragraph 27 of IFRS 17 at the end of each reporting period, if facts and circumstances indicate the asset may be impaired.

 © IFRS Foundation

BC43 Requiring an entity to test such an asset for impairment only when facts and circumstances indicate the asset may be impaired is consistent with the requirement in paragraph 26 of IFRS 17 for the recognition of a group of onerous contracts before coverage begins or payments from policyholders are due.

BC44 Consistent with the impairment test in paragraph 101 of IFRS 15, an entity would recognise an impairment loss in profit or loss and reduce the carrying amount of an asset for insurance acquisition cash flows so that it does not exceed the expected net cash inflow for the related group.

BC45 The Board observed that an impairment test at a group level (as described in paragraph BC44) compares the carrying amount of an asset for insurance acquisition cash flows allocated to a group with the expected net cash inflow of the group. That net cash inflow includes cash flows for expected renewals of contracts with current policyholders and cash flows for contracts with future policyholders expected to be in that same group. The Board decided to require an additional group impairment test specific to cash flows for expected contract renewals. The additional impairment test results in the recognition of any impairment losses on expected future renewals when the entity no longer expects those renewals to occur. Without the additional impairment test, cash flows from future policyholder contracts might prevent the recognition of such an impairment loss.

Proposed additional disclosure requirements

BC46 In the Board's view, given the proposed amendment would extend the period for which an asset for insurance acquisition cash flows would be recognised, it is useful for users of financial statements to know when that asset is expected to be derecognised and the insurance acquisition cash flows are expected to be included in the measurement of a group of insurance contracts. Accordingly, the Board decided to propose that an entity should disclose a reconciliation from the opening to the closing balance of any asset recognised applying paragraph 28B(b) of the Exposure Draft. The Board also decided to propose quantitative disclosure, in appropriate time bands, of the expected inclusion of insurance acquisition cash flows recognised as an asset in the measurement of the group of insurance contracts to which they are allocated (see paragraph 105A of the Exposure Draft).

Other approaches considered and rejected

BC47 The Board noted that the requirements for insurance acquisition cash flows as defined in IFRS 17 are not directly comparable to the requirements for the incremental costs of obtaining a contract in IFRS 15. The Board considered whether, rather than aligning just one aspect of the requirements, it should align all the related requirements.

BC48 Specifically, the Board considered whether, to increase consistency with IFRS 15, the amendment should apply only to insurance acquisition cash flows that are incremental to the costs of obtaining a contract, consistent with paragraph 92 of IFRS 15. The definition for insurance acquisition cash flows in IFRS 17 is broader than the incremental costs of obtaining a contract in

IFRS 15. However, the Board decided that limiting the amendment to IFRS 17 to a narrower range of costs than those that meet the definition of insurance acquisition cash flows would be inconsistent with the costs included in the measurement of insurance contracts.

BC49 The Board also considered an alternative amendment to IFRS 17 suggested by stakeholders relating to the contract boundary requirements. Applying paragraph 34 of IFRS 17, cash flows for expected renewals of contracts are within the boundary of the original contract if, and only if, the entity has either a substantive right or a substantive obligation that arises from those renewals of contracts (for example, if the entity has promised the policyholder a renewal at a pre-determined rate). Some stakeholders suggested that the contract boundary requirements could be amended to require all expected renewals of contracts to be within the boundary of the original contract, even if the entity does not have a substantive right or a substantive obligation relating to those renewals. However, the Board concluded that such an amendment would be inconsistent with the core principle in IFRS 17 of accounting for an entity's substantive rights and obligations that arise from an insurance contract.

Contractual service margin attributable to investment-return service and investment-related service (paragraphs 44–45, 109 and 117(c)(v), Appendix A and paragraphs B119–B119B)

Proposed amendment

BC50 IFRS 17 requires an entity to recognise the contractual service margin, which is the unearned profit in a group of insurance contracts, in profit or loss over time on the basis of coverage units. The number of coverage units in a group of contracts is determined by considering, for each contract, the quantity of the benefits provided under the contract and the expected period over which those benefits will be provided. The Exposure Draft proposes two amendments relating to the identification of coverage units applying paragraph B119:

(a) the first proposed amendment would require an entity to identify coverage units for insurance contracts without direct participation features considering the quantity of benefits and expected period of investment-return service, if any, in addition to insurance coverage. Paragraph B119B specifies criteria for when such contracts may provide an investment-return service.

(b) the second proposed amendment would clarify that an entity is required to identify coverage units for insurance contracts with direct participation features considering the quantity of benefits and expected period of both insurance coverage and investment-related service.

 © IFRS Foundation

BC51 For all insurance contracts, the Exposure Draft proposes to amend paragraph 109 of IFRS 17 to require an entity to disclose quantitative information about when the entity expects to recognise in profit or loss the contractual service margin remaining at the end of the reporting period. In the light of the proposals to broaden the range of services considered when identifying coverage units and allocating the contractual service margin to coverage units, the Board also proposes to require an entity to disclose the approach used to assess the relative weighting of the benefits from insurance coverage and investment-related service or investment-return service applying paragraph 117(c)(v) of the Exposure Draft.

BC52 The Exposure Draft proposes that insurance coverage, investment-return service (for insurance contracts without direct participation features) and investment-related service (for insurance contracts with direct participation features) are defined together as 'insurance contract services'.

BC53 The Exposure Draft also proposes consequential amendments to the definitions of 'contractual service margin', 'coverage period', 'liability for remaining coverage' and 'liability for incurred claims', and to the eligibility criteria for the premium allocation approach to reflect the amendments relating to the insurance contract services provided by the group of insurance contracts in the period.

Rationale for changing the requirements

BC54 A question submitted to the Transition Resource Group for IFRS 17 indicated that it would be useful to clarify that an entity is required to consider investment-related service when determining coverage units for insurance contracts with direct participation features. Transition Resource Group members thought coverage units for contracts with direct participation features should include investment-related service because those contracts are substantially investment-related service contracts. However, Transition Resource Group members held different views on whether IFRS 17 requires, permits or prohibits such an approach. Hence, the Board decided to clarify that such an approach is required.

BC55 After deciding to clarify the requirements for insurance contracts with direct participation features, the Board considered feedback from some Transition Resource Group members and other stakeholders that the requirements should be changed for some insurance contracts without direct participation features. Those stakeholders explained that the requirement to recognise the contractual service margin considering only insurance coverage would fail to faithfully represent the entity's financial performance across periods, in particular when:

(a) a contract provides insurance coverage that ends before the policyholder ceases to earn investment returns; or

(b) a deferred annuity contract with an accumulating account balance provides insurance coverage only during the annuity period.

BC56 The Board noted arguments that some insurance contracts without direct participation features provide policyholders with a return that depends on underlying items, similar to insurance contracts with direct participation features. Although these contracts do not meet the conditions to be within the scope of the variable fee approach, the Board was persuaded that some such contracts provide an investment service because the contract includes an investment component or the policyholder has a right to withdraw an amount from the entity that is expected to include an investment return. Such a service is referred to in the proposed amendments as an investment-return service. The Board was persuaded that, particularly for contracts that have an insurance coverage period that differs from the period in which the policyholder benefits from such a service, recognising the contractual service margin in profit or loss considering both the insurance coverage and an investment-return service provides useful information to users of financial statements.

BC57 In developing the proposed amendments in the Exposure Draft, the Board considered:

(a) the determination of when an investment-return service could exist (paragraphs BC58–BC61);

(b) subjectivity in the weighting of services (paragraph BC62);

(c) costs included in the fulfilment cash flows (paragraph BC63); and

(d) subsequent adjustments to the contractual service margin (paragraphs BC64–BC65).

Determination of when an investment-return service could exist

BC58 The Board observed that an investment-return service could be identified in some insurance contracts without direct participation features that include an investment component (that is, insurance contracts that require an entity to repay an amount to the policyholder in *all* circumstances). In addition, the Board considered whether an investment-return service could be identified in some insurance contracts without an investment component. The Board concluded an investment-return service could be provided in some insurance contracts that do not include an investment component, but that require the entity to repay amounts to the policyholder, other than claims for insured events, in *some* circumstances. In the Board's view, an investment-return service might be provided during the period when a policyholder has a right to withdraw an amount from the entity. The Board decided to describe this right as a 'right to withdraw an amount from the entity' in order to include both policyholders' rights to a surrender value or premium refund on cancellation of a policy and policyholders' rights to transfer an amount to another insurance provider. The Board concluded that an investment-return service cannot exist if the contract does not include an investment component or the policyholder does not have a right to withdraw an amount from the entity, because, in that case, the policyholder does not have the right to benefit from investment returns.

 © IFRS Foundation

BC59 The Board considered whether there is always an investment-return service when there is an investment component or when the policyholder has a right to withdraw an amount from the entity. The Board considered an example of a car insurance contract in which the policyholder has a right, on cancellation of the contract, to a refund of premiums paid in advance for future service. The Board concluded that often such a contract would not provide an investment-return service—the entity is not expecting to generate a return for the policyholder. Similarly, the Board observed that an entity does not provide an investment-return service when the entity provides only custodial services. Accordingly, the Board decided to specify criteria in paragraph B119B of the Exposure Draft for identifying when an investment-return service may exist.

BC60 The Board also considered whether a contract that meets the criteria in paragraph B119B of the Exposure Draft would always provide an investment-return service. The Board was persuaded that identifying such an investment-return service should be a matter of judgement for the entity and concluded that the criteria were necessary for identifying, but not determinative of, the existence of such a service.

BC61 The Board noted that, for some insurance contracts (both those with and without direct participation features), an investment return might be paid to future policyholders, rather than to current policyholders. Those payments might occur long after the service provided to the current policyholders has ended. The Board concluded that such delayed recognition of the contractual service margin would not be appropriate because the period of investment-return service or investment-related service ends by the date that all amounts relating to those services due to current policyholders have been paid.

Subjectivity in the weighting of services

BC62 Including an investment-return service in addition to insurance coverage in the determination of coverage units for insurance contracts without direct participation features adds subjectivity and complexity to that determination. If an investment-return service is identified, an entity would need to assess the relative weighting of the benefits provided by the investment-return service and the insurance coverage, and the pattern of delivery of each of those services. However, the Board noted that entities are already required to make similar assessments for insurance contracts with direct participation features and for contracts that provide more than one type of insurance coverage. Furthermore, the proposed disclosure set out in paragraph 109 of the Exposure Draft would provide users of financial statements with useful information about the pattern of service provision. Therefore, the Board concluded it is sufficient to require the weighting of benefits from insurance coverage and investment-return service when determining coverage units to be assessed on a systematic and rational basis.

Costs included in the fulfilment cash flows

BC63 The Board discussed whether the costs of managing assets that form underlying items for insurance contracts should be included in the fulfilment cash flows of insurance contracts without direct participation features or insurance contracts with direct participation features. Fulfilment cash flows

are cash flows that relate directly to the fulfilment of a contract, including an allocation of fixed and variable overheads. For insurance contracts with direct participation features, an entity is regarded as managing assets on behalf of policyholders. It follows that asset management costs should be regarded as part of the cost of fulfilling the contracts and hence included in the fulfilment cash flows. Similarly, the Board concluded that to the extent an entity determines an investment-return service exists in insurance contracts without direct participation features, the entity should include cash flows related to the fulfilment of that service in the fulfilment cash flows.

Subsequent adjustments to the contractual service margin

BC64 After initial recognition, the contractual service margin is adjusted for changes in fulfilment cash flows that relate to future service. For insurance contracts without direct participation features, all changes in assumptions that relate to financial risk are regarded as relating to the current period, and thus do not adjust the contractual service margin. In contrast, for insurance contracts with direct participation features, some changes in assumptions that relate to financial risk are regarded as relating to future service.

BC65 The Board considered whether the proposed amendment as described in paragraph BC50(a) has any implications for the types of changes in fulfilment cash flows that are regarded as relating to future service for insurance contracts without direct participation features. For example, the Board considered whether some changes in financial assumptions should be regarded as relating to future service similar to insurance contracts with direct participation features. However, the contractual service margin for insurance contracts with direct participation features is remeasured for changes in the fair value of underlying items because of the nature of the variable fee for service, not because of the types of service provided by the contract. Other effects of changes in assumptions that relate to financial risk adjust the contractual service margin because it is not possible to separate them from the changes in fair value of the underlying items. The extension of the type of service considered when determining coverage units does not change the nature of the fee in insurance contracts without direct participation features. Hence, the Board concluded it should not amend the treatment of the effects of changes in assumptions related to financial risk.

Other approaches considered and rejected

BC66 Some stakeholders suggested that the requirements in IFRS 17 for recognition of the contractual service margin in profit or loss are too specific and should be replaced with a more general requirement to recognise the contractual service margin in profit or loss each period based on all services provided by the contract. To do so, an entity would apply judgement to decide what services are provided by the contract. However, generally, those stakeholders observed that their specific concerns were about services related to investment returns, rather than to other services. The Board regards the recognition of the contractual service margin in profit or loss as a fundamental aspect of the depiction of the performance of a group of insurance contracts. Although there is inevitable subjectivity in determining the pattern of service provision,

 © IFRS Foundation

specifying that the contractual service margin is recognised by considering all services would likely result in more subjectivity. The Board concluded that the proposed amendment responds to feedback that some insurance contracts without direct participation features have two defining services—insurance coverage and investment-return service. Thus, the proposed amendment balances concerns about faithful representation, comparable information and cost-benefit.

Reinsurance contracts held—recovery of losses on underlying insurance contracts (paragraphs 62, 65, 66(ba), 66A–66B, 70A, 86, B95B–B95C, B119C–B119F, C15A and C20A)

Proposed amendment

BC67 A reinsurance contract held may cover one or many underlying insurance contracts. An entity that purchases a reinsurance contract has rights (to receive service) and obligations (to pay premiums) from that contract which are separate from the entity's rights (to receive premiums) and obligations (to provide service) from the insurance contracts it issues. Accordingly, applying IFRS 17, a reinsurance contract held is accounted for separately from any underlying insurance contracts.

BC68 Often, an entity that holds a reinsurance contract will expect to incur an overall net cost (that is, it expects to pay to the reinsurer more premiums than it expects to be reimbursed for claims, after taking into account the risk adjustment for non-financial risk). However, in some circumstances, the entity may expect to make an overall net gain (that is, it expects to pay to the reinsurer premiums that are lower than the claims it expects to be reimbursed from the reinsurer, after taking into account the risk adjustment for non-financial risk). The overall expected net cost or net gain is the contractual service margin for the reinsurance contract held at initial recognition.

BC69 IFRS 17 requires an entity to recognise the expected net cost or net gain of purchasing reinsurance in profit or loss as services are received from the reinsurer. This timing of recognition is consistent with the treatment of the costs of receiving a future service in other IFRS Standards and the treatment of profits on insurance contracts issued in IFRS 17. It differs from the treatment of losses on insurance contracts issued in IFRS 17, which are recognised immediately in profit or loss. The treatment of the net cost or net gain of purchasing reinsurance differs from the treatment of the loss on insurance contracts because:

(a) a net cost on a reinsurance contract held creates a right to receive a future service that is an asset for the entity—incurring a loss on underlying insurance contracts does not create a similar right; and

(b) a net gain on a reinsurance contract held represents a reduction in the cost of purchasing reinsurance that should be recognised over the period service is received—incurring a loss on underlying insurance contracts is not a reduction in the cost of a service that is received.

BC70 Usually IFRS 17 requires changes in fulfilment cash flows that relate to future service to adjust the contractual service margin. However, applying the exception for reinsurance contracts held in paragraph 66(c)(ii) of IFRS 17, when a change in a group of underlying insurance contracts relates to future service but results in the group becoming onerous or more onerous (and, therefore, is recognised in profit or loss immediately), any corresponding change in the reinsurance contract held is also recognised in profit or loss immediately. The Board included the exception in paragraph 66(c)(ii) of IFRS 17 because it was persuaded that changes in estimates of cash outflows on a group of underlying insurance contracts should have no net effect in profit or loss for the period, to the extent they result in corresponding changes in cash inflows from a reinsurance contract held.

BC71 Paragraph 66A of the Exposure Draft proposes a further exception—that an entity would be required to adjust the contractual service margin of a group of reinsurance contracts held that provide proportionate coverage, and as a result recognise income, when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to that group. The amount of the adjustment and resulting income is determined as equal to the loss recognised on the group of underlying insurance contracts multiplied by the fixed percentage of claims on the group of underlying insurance contracts the entity has a right to recover from the issuer of the reinsurance contract.

BC72 The Exposure Draft proposes to specify that if an entity chooses to present separately the amounts recovered from the reinsurer and an allocation of the premiums paid applying paragraph 86 of IFRS 17, the income arising applying paragraph 66A of the Exposure Draft would be included in amounts recovered from the reinsurer.

BC73 The Exposure Draft proposes consequential amendments in paragraphs B95B–B95C for insurance contracts acquired and in paragraphs C15A and C20A for the transition requirements in IFRS 17. With respect to the transition requirements, a modification is added to the modified retrospective approach and a relief is added to the fair value approach.

BC74 The Board decided that it does not need to propose additional disclosures as a result of the proposed amendment in paragraph 66A of the Exposure Draft. The Board noted that the requirement in paragraph 98 of IFRS 17 that an entity adapt the disclosure requirements for insurance contracts issued to reflect the features of reinsurance contracts held would be sufficient. Applying the proposed amendment, the recovery of a loss on a reinsurance contract held would be treated similarly to the loss component on insurance contracts issued.

 © IFRS Foundation

Rationale for changing the requirements

BC75 Some stakeholders expressed concerns that an entity recognises a loss in profit or loss immediately when an onerous group of insurance contracts is recognised and also when new contracts are added to the group, even when an entity has purchased a reinsurance contract that provides coverage for those contracts. The entity has the right to recover some or all the claims that contribute to these losses, regardless of whether the entity expects to incur a net cost or make a net gain on the reinsurance contract held. Accordingly, some stakeholders suggested that, to the extent an entity has a right to recover from a reinsurer a loss recognised on underlying contracts, it should recognise income representing that expected recovery at the same time it recognises the loss on the underlying contracts.

BC76 When considering those stakeholders' concerns, the Board reaffirmed its view that an entity should account for a reinsurance contract held separately from the underlying insurance contracts issued, and the accounting for a reinsurance contract held should be consistent with that for an insurance contract issued. However, the Board acknowledged that accounting mismatches could arise from the different treatment of losses on groups of insurance contracts and the recognition of the net cost or net gain of reinsurance contracts held described in paragraph BC68.

BC77 Such accounting mismatches were particularly evident in an example stakeholders provided, in which all cash flows between the insurer and the reinsurer are a specified fixed percentage (for example, 30 per cent) of all cash flows between the insurer and the policyholders of the onerous underlying insurance contracts. In this example, because all cash flows between the insurer and the reinsurer are a specified fixed percentage of all cash flows between the insurer and the policyholders of the onerous underlying insurance contracts, there is a direct association between the loss on the underlying contracts and the net gain on the reinsurance contract held. In that example, everything that determines the loss also affects the net gain in a directly identifiable way. However, that example is highly simplified and does not include features that exist in many reinsurance contracts. Often, the reinsurer will provide proportionate coverage for claims cash flows, however other cash flows are not proportionate. For example, the reinsurer may charge a lower premium for taking on risk, or the reinsurer may charge a single premium for taking on risks for both profitable and onerous underlying contracts, which can only be allocated arbitrarily between those underlying contracts.

BC78 In analysing the accounting mismatch evident in the example in paragraph BC77 to understand whether or when that mismatch arises in less simplified circumstances, the Board observed that a loss recognised for an onerous group of contracts could be regarded as early recognition of claims, before the claims are incurred. However, applying the requirements of IFRS 17, the recoveries for the claims from the reinsurance contract held are only recognised when the claims are incurred. This timing mismatch exists regardless of whether the reinsurance contract held creates a net cost or a net gain. This timing mismatch would be avoided if IFRS 17 were amended to

© IFRS Foundation

require an entity to recognise early the recoveries related to claims, at the same time as those claims are recognised. Accordingly, the Board considered:

(a) when it is possible to identify recoveries related to the claims that are recognised early; and

(b) whether early recognition of such recoveries should have any consequences for the timing of recognition of the cost of the recoveries (the allocation of the premiums paid for the reinsurance contract held).

BC79 With respect to paragraph BC78(a), the Board observed that for all reinsurance contracts held there is a link between the expected recoveries and the loss recognised on underlying onerous contracts: they both depend on expected claims. The Board concluded that a reasonable practical assumption would be that the loss on underlying insurance contracts issued is caused by claims cash flows, rather than by any other fulfilment cash flows included in the measurement of the contracts (to the extent that the loss does not exceed the claims cash flows included in the measurement of the contracts).

BC80 For reinsurance contracts held that provide proportionate coverage (that is, coverage for a fixed percentage of all claims from underlying contracts), making that assumption would allow an entity to identify the loss as being caused by claims that will be recovered from the reinsurer at the fixed proportion at which all claims are recovered. For example, if a reinsurance contract held provides coverage for 30 per cent of all claims on underlying insurance contracts, a loss of CU100 caused by claims will result in a recovery equal to CU30 (30 per cent of the loss of CU100). In contrast, for reinsurance contracts held that do not provide proportionate coverage, although it is possible to identify the loss as being caused by claims, those claims do not have a known recovery. For example, consider a reinsurance contract held that provides coverage to the extent that claims exceed CU100, and the underlying insurance contracts have expected premiums of CU300 and expected claims of CU350. The entity recognises a loss on the underlying insurance contracts of CU50. That loss can be regarded as early recognition of claims of CU50, but it is not possible to know whether those claims of CU50 are claims that would result in a recovery, or to what extent, because the reinsurance contract only covers excess of claims over CU100.

BC81 The Board concluded that a timing mismatch between the recognition of claims and the recognition of recoveries could be directly identified for reinsurance contracts held that provide proportionate coverage, but not for other reinsurance contracts held. For other reinsurance contracts held, the claims that cause the loss do not have known recoveries. Accordingly, the Board decided to propose an amendment only for reinsurance contracts held that provide proportionate coverage.

BC82 Changing the timing of the recognition of recoveries in this way leads to the question in paragraph BC78(b) of whether the early recognition of recoveries should change the pattern of recognition of the cost of recoveries. For onerous insurance contracts issued, the recognition of a loss (identified as early recognition of claims) does not affect the recognition of revenue—no revenue

 © IFRS Foundation

is recognised in relation to claims that are not expected to be covered by the consideration received by the entity. To achieve a similar outcome for a reinsurance contract held (that is, to recognise income as a result of the early recognition of the recoveries), the Board concluded that the early recognition of recoveries should not affect the pattern of recognition of the cost of recoveries.

BC83 Consequently, the proposed amendment results in the pattern of recognition of recoveries differing from the pattern of recognition of the cost of recoveries. An entity will recognise in profit or loss the recovery of a loss (that is, the expected reinsurance claims) immediately and the cost of recovering that loss (that is, the reinsurance premiums) as reinsurance services are received. This, in itself, could be regarded as an accounting mismatch. Essentially, an entity will recognise a benefit immediately and a larger cost over the service period.

BC84 On balance, in the Board's view, more useful information is provided by (a) eliminating the accounting mismatch between the recognition of the loss on the underlying contracts and the recovery of that loss by the reinsurance contract held in those cases that the mismatch can be identified, than would be provided by (b) matching the recovery of claims with their cost.

BC85 To apply paragraph 66A of the Exposure Draft, the reinsurance contract held must be recognised before or at the same time that the loss is recognised on the onerous group of underlying insurance contracts. The Board concluded that such a condition was necessary to ensure that the recovery of losses are recognised at the same time as the losses.

Other approaches considered and rejected

BC86 The Board considered whether the proposed amendment in paragraph 66A of the Exposure Draft should also apply to reinsurance contracts held that do not provide proportionate coverage. However, as explained in paragraphs BC80–BC81, for these contracts an entity would be required to make more arbitrary assumptions, beyond the assumption that a loss is caused only by claims, to identify the extent to which expected recoveries relate to a loss recognised on underlying insurance contracts. Consider a reinsurance contract held that provides coverage for claims over a specified excess on:

(a) one insurance contract that the entity issues—the entity would need to make an arbitrary assumption about which claims cause the contract to be onerous, because the reinsurance contract held does not cover all claims.

(b) all insurance contracts that the entity issues in a specific period—the entity would need to make an arbitrary assumption about which contracts cause the entity to expect to reach the specified excess on the reinsurance contract held, because the specified excess is not likely to be exceeded by one insurance contract. For example, the question would arise as to whether any recovery of losses should be recognised when the first onerous insurance contract the entity issues in the period is recognised.

BC87 Hence, for reinsurance contracts held that do not provide proportionate coverage, the Board concluded it is not possible to identify the accounting mismatch described in paragraph BC76 and, therefore, it is not possible to eliminate the timing mismatch without affecting the accounting for broader aspects of the reinsurance contract held, which may differ economically from the underlying insurance contracts. The Board noted that stakeholders identified concerns related mainly to the accounting mismatch that arises when reinsurance contracts held provide proportionate coverage.

BC88 The Board noted that the existing exception in paragraph 66(c)(ii) of IFRS 17, which relates to changes in cash flows, applies to all types of reinsurance contracts held. That exception addresses a change in the fulfilment cash flows of the reinsurance contract held that results from a change in a group of underlying insurance contracts. The change in the fulfilment cash flows of the reinsurance contract held provides information about the extent to which the reinsurance contract held covers the change in the loss on the underlying contracts, regardless of whether claims are covered on a proportionate basis.

BC89 Some stakeholders suggested the Board could resolve the accounting mismatch described in paragraph BC76 by amending the accounting for the underlying insurance contracts. Some stakeholders suggested that, to the extent that onerous insurance contracts are covered by a reinsurance contract held on a proportionate basis, the loss on those insurance contracts should be a negative contractual service margin that is recognised as services are provided.

BC90 The Board considered and rejected this suggestion because it is inconsistent with the Board's objective to recognise losses on insurance contracts when expected and profits on insurance contracts when earned. With the proposed amendment, IFRS 17 would continue to provide timely information about onerous groups of insurance contracts issued.

Presentation in the statement of financial position (paragraphs 78–79, 99 and 132)

Proposed amendment

BC91 The Exposure Draft proposes to amend paragraph 78 of IFRS 17, which requires an entity to present separately in the statement of financial position the carrying amount of groups of insurance contracts issued that are assets and those that are liabilities and the carrying amount of groups of reinsurance contracts held that are assets and those that are liabilities.

BC92 The proposed amendment to paragraph 78 of IFRS 17 would require an entity to instead present separately in the statement of financial position the carrying amounts of portfolios of insurance contracts issued that are assets and those that are liabilities and portfolios of reinsurance contracts held that are assets and those that are liabilities. There are no proposed changes to the measurement requirements of IFRS 17 as a result of this proposed amendment.

© IFRS Foundation

BC93 The Exposure Draft proposes consequential amendments to paragraph 79 of IFRS 17 and to the disclosure requirements in paragraphs 99 and 132 of IFRS 17 to reflect a portfolio rather than a group level of presentation.

Rationale for changing the requirements

BC94 The requirements in IFRS 17 for presenting groups of insurance contracts are consistent with the requirements for recognising and measuring groups of insurance contracts. The fulfilment cash flows included in the measurement of insurance contracts are the same regardless of the level at which they are measured. However, an entity is required to allocate fulfilment cash flows that relate to remaining coverage at a group level to determine and recognise the contractual service margin (or loss on onerous contracts).

BC95 Some stakeholders expressed concerns that identifying fulfilment cash flows for each group of insurance contracts typically requires integrating independent systems, such as cash management systems and actuarial systems at a level of a group of contracts. Some of those fulfilment cash flows do not need to be allocated to groups to apply the measurement requirements of IFRS 17, for example, amounts related to the settlement of incurred claims. Those stakeholders explained that new systems would need to be implemented to apply this aspect of IFRS 17, at significant cost. Those stakeholders suggested that presenting insurance contracts at a level that is higher than a group level would provide them with a meaningful practical relief that, in their view, would not significantly diminish the usefulness of information for users of financial statements.

BC96 Feedback from initial outreach with users of financial statements supports the stakeholder views set out in paragraph BC95—that presenting insurance contracts at a level that is higher than a group level would not significantly diminish the usefulness of information when compared to presentation at a group level. Considering this information, the Board concluded that the benefit of the proposed amendment to paragraph 78 of IFRS 17 (operational relief for preparers of financial statements) would outweigh the cost (potential limited loss of useful information for users of financial statements).

Other approaches considered and rejected

BC97 The Board considered some stakeholders' suggestions that presentation of insurance contracts in the statement of financial position should be at an entity level and rejected that suggestion because that would risk a greater loss of useful information for users of financial statements.

BC98 Some stakeholders expressed operational concerns relating to the premium allocation approach, similar to those described in paragraph BC95, in particular because of the operational cost of identifying premiums received at a group level to measure the liability for remaining coverage applying paragraphs 55(a)(i) and 55(b)(i) of IFRS 17. Some stakeholders suggested that it would be easier to apply those requirements if they referred to premiums receivable instead of premiums received. The Board disagreed with the suggestion to amend the requirements in paragraphs 55(a)(i) and 55(b)(i) of IFRS 17 to refer to premiums receivable because such an amendment would

© IFRS Foundation

result in the premium allocation approach no longer meeting its objective of approximating the general model. The insurance contract liability under the premium allocation approach would be grossed up for the premiums receivable, unlike insurance contract liabilities under the general model which include all future cash flows in their carrying amount. The Board did, however, note that the proposed amendment to paragraph 78 of IFRS 17 would provide some relief for entities applying the premium allocation approach because that amendment would permit entities to achieve the outcome required by IFRS 17 using a higher level of aggregation for premiums received, in some cases.

BC99 Applying IFRS 4, some entities present separately in the statement of financial position different amounts arising from an insurance contract, as if those different amounts were separate assets or liabilities. For example, some entities present line items labelled as premiums receivable, claims payable and deferred acquisition costs separately from the insurance contract liability. Different entities present different line items and have different definitions of what those line items are (for example, some entities present as premiums receivable amounts that are not yet billed while other entities present only billed amounts). Some stakeholders expressed the view that they would like to continue that practice of further disaggregation because they view such disaggregated line items as providing meaningful information to users of financial statements. The Board disagreed with the suggestion to amend IFRS 17 to permit that practice to continue because it could result in the presentation of amounts that are not separable assets or liabilities. For example, premiums receivable for future coverage is not a gross asset separable from the related liability for the future coverage.

BC100 Furthermore, the requirement to present rights and obligations arising from an insurance contract together on the statement of financial position will significantly improve comparability both within the insurance industry and with other industries. In turn, this improved comparability is expected to significantly improve understandability for users of financial statements.

Applicability of the risk mitigation option (paragraph B116)

Proposed amendments

BC101 The Exposure Draft proposes to extend the option in paragraphs B115–B116 of IFRS 17 relating to the accounting treatment of some types of risk mitigation. That option permits an entity to reflect some or all of the changes in the effect of financial risk on insurance contracts with direct participation features that usually adjust the contractual service margin immediately in profit or loss. An entity may apply that option if, and only if, the entity mitigates those financial risks using derivatives and meets the conditions in paragraph B116 of IFRS 17. Without that exception, the variable fee approach would create an accounting mismatch when an entity uses derivatives to mitigate financial risk in insurance contracts. Specifically:

© IFRS Foundation

(a) the change in the fair value of the derivative would be recognised in profit or loss applying IFRS 9; but

(b) the change in the insurance contract, the risk of which was mitigated by the derivative, would adjust the contractual service margin applying paragraph 45 of IFRS 17.

BC102 The proposed amendment in paragraph B116 of the Exposure Draft would extend that option to be available when an entity mitigates financial risk on insurance contracts with direct participation features using reinsurance contracts held.

BC103 The Board concluded that additional disclosures as a result of this amendment would not be needed because the existing disclosures relating to paragraphs B115–B116 of IFRS 17 would be sufficient.

Rationale for changing the requirements

BC104 Some entities purchase reinsurance contracts that cover insurance contracts with direct participation features that the entities issue. Those reinsurance contracts transfer both non-financial risk and financial risk to the reinsurer.

BC105 All reinsurance contracts held are accounted for applying the general measurement requirements in IFRS 17. Similar to previous feedback about derivatives, stakeholders expressed concern that an accounting mismatch arises because:

(a) the change resulting from financial risk in a reinsurance contract held would be recognised in profit or loss applying paragraph 87 of IFRS 17; but

(b) the change resulting from financial risk in underlying insurance contracts with direct participation features would adjust the contractual service margin applying paragraph 45 of IFRS 17.

BC106 The Board acknowledged that the concern expressed by stakeholders for reinsurance contracts held is similar to the concern previously raised in relation to derivatives—the identified accounting mismatches are created by the variable fee approach. The Board decided to propose an amendment to IFRS 17 that extends the scope of the risk mitigation option in paragraph B116 of IFRS 17 to address this concern. As a consequence of the proposed amendment, the accounting for insurance contracts with direct participation features may be different depending on whether the entity has purchased a reinsurance contract. However, the Board concluded that such an amendment would be acceptable because it is consistent with the option introduced previously to address a similar concern for derivatives.

Other approaches considered and rejected

BC107 Some stakeholders suggested the Board could resolve this accounting mismatch for reinsurance contracts held by permitting an entity to choose to account for reinsurance contracts held applying the variable fee approach if the underlying insurance contracts are insurance contracts with direct participation features. The Board disagreed with this suggestion because the

variable fee approach was designed specifically so that profit earned by an entity issuing insurance contracts that are substantially investment-related service contracts would be accounted for similarly to the profit earned by an entity issuing asset management contracts. When an entity purchases a reinsurance contract, it does not provide asset management services, rather, it receives insurance coverage.

BC108 Some stakeholders suggested that the risk mitigation option should apply also when an entity uses financial instruments other than derivatives, for example, bonds, to mitigate financial risk. The Board disagreed with this suggestion because the risk mitigation option was designed to address a specific accounting mismatch between insurance contracts with direct participation features and derivatives that arises because of the introduction of the variable fee approach. It was not intended to address broader risk mitigation activities. The Board also noted that IFRS 9 and IAS 39 include general hedge accounting requirements and IAS 39 includes specific 'macro hedge accounting' requirements (fair value hedge accounting for portfolio hedges of interest rate risk) that may enable entities to address some accounting mismatches.

BC109 Some stakeholders suggested that a risk mitigation option should be added to address perceived accounting mismatches that might arise if an entity applies the option in paragraph 88 of IFRS 17 to recognise some insurance finance income or expenses in other comprehensive income. Those mismatches might arise for both insurance contracts without direct participation features and insurance contracts with direct participation features. The Board disagreed with this suggestion, because an entity can avoid such mismatches by not applying the option.

Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4 (paragraph C1 and [Draft] Amendments to IFRS 4)

Proposed amendments

BC110 Applying paragraph C1 of IFRS 17, an entity is required to apply IFRS 17 for annual reporting periods beginning on or after 1 January 2021. An entity can choose to apply IFRS 17 before that date but only if it also applies IFRS 9 and IFRS 15.

BC111 IFRS 4 as amended in September 2016 permits:

(a) entities whose predominant activities are connected with insurance to defer the application of IFRS 9 until 2021; and

(b) all issuers of insurance contracts to recognise in other comprehensive income, rather than profit or loss, amounts resulting from additional accounting mismatches and volatility that may arise when IFRS 9 rather than IAS 39 is applied in conjunction with IFRS 4.

BC112 The Exposure Draft proposes an amendment to IFRS 17 and a related amendment to IFRS 4, as follows:

© IFRS Foundation

(a) the proposed amendment to paragraph C1 of IFRS 17 would defer the effective date of IFRS 17 by one year so entities would be required to apply IFRS 17 for annual reporting periods beginning on or after 1 January 2022. In addition, the Exposure Draft proposes to delete the reference to IFRS 15 in paragraph C1 of IFRS 17 because IFRS 15 must be applied for annual reporting periods beginning on or after 1 January 2018.

(b) the proposed amendment in paragraph 20A of IFRS 4 would extend the temporary exemption from IFRS 9 by one year so that an entity applying the exemption would be required to apply IFRS 9 for annual reporting periods beginning on or after 1 January 2022.

Rationale for changing the requirements

BC113 Some stakeholders expressed the view that the effective date of IFRS 17 should be deferred because implementing IFRS 17 is a significant challenge. The Board considered, but was not persuaded by, this view because it considered the challenges for entities in applying IFRS 17 when it set the effective date. Accordingly, the Board allowed sufficient time between May 2017 when IFRS 17 was issued and the effective date of 1 January 2021 for entities to implement IFRS 17.

BC114 The Board's decision to defer the effective date of IFRS 17 by one year reflects a balance between:

(a) providing certainty about the effective date of IFRS 17 considering the uncertainty caused by the Board's decision to explore possible amendments to IFRS 17 in October 2018; and

(b) requiring IFRS 17 implementation as soon as possible because:

(i) IFRS 17 is a Standard urgently needed to address many inadequacies in existing accounting practices for insurance contracts; and

(ii) undue delay in the effective date of the Standard would increase workload and costs, particularly for entities that are advanced in their implementation projects.

BC115 The Board noted stakeholder views that there is benefit in extending the temporary exemption from IFRS 9 so entities can first apply IFRS 9 and IFRS 17 at the same time. The Board was reluctant to extend the temporary exemption by a further year, because this would mean that some entities (including entities with significant holdings of financial assets) will first apply IFRS 9 up to eight years after IFRS 9 was issued and up to four years after other entities first applied IFRS 9. However, for the same reasons that previously resulted in the deferral of IFRS 9 for insurers as set out in paragraph BC111(a), the Board considered on balance the benefit of extending the period that the relief is available by one year, so insurers can apply IFRS 17 and IFRS 9 at the same time, outweighs the disadvantage of an additional one-year delay to the improved information that will result from insurers applying IFRS 9.

BC116 The Board noted that any further extension of the effective date of IFRS 9 would be undesirable, particularly in the absence of more robust disclosures about expected credit losses (see paragraphs BC271–BC272 of the Basis for Conclusions on IFRS 4). Extending the period of the temporary exemption from IFRS 9 will:

(a) delay the provision of better information, particularly in relation to credit risk, by some insurers, many of whom are significant holders of financial assets; and

(b) result in continuing complexity for users of financial statements that compare insurers to each other and to other entities, because of the continuing existence and use of different Standards for financial instruments.

Other approaches considered and rejected

BC117 On initial application of IFRS 17, an entity is required to restate comparative information about insurance contracts for the annual reporting period immediately preceding the date of initial application. The Board considered a suggestion from some stakeholders that, rather than delaying the effective date of IFRS 17, the Board could permit entities not to present adjusted comparative information on initial application of IFRS 17. Some stakeholders also expressed the view that including the comparative year information would create an accounting mismatch in the comparative information because an entity is only allowed to provide comparative information when applying IFRS 9 for the first time if it can do so without the use of hindsight. The Board disagreed with the suggestion that it should permit entities not to present adjusted comparative information on initial application of IFRS 17 because the Board views the restatement of comparative information about insurance contracts on initial application of IFRS 17 as necessary to allow users of financial statements to assess the effects of applying IFRS 17 for the first time. As the Board noted when IFRS 17 was issued, the Board views the restatement of comparative information as particularly important given the diversity in previous accounting practices and the extent of change introduced by IFRS 17. Furthermore, an entity can avoid accounting mismatches because it is permitted to restate comparative information applying IFRS 9 and has the opportunity to start collecting information to be able to do so without the use of hindsight.

BC118 Some stakeholders expressed concern that even if they could restate comparative information applying IFRS 9 without the use of hindsight, the transition requirements in IFRS 9 would prohibit entities from applying IFRS 9 to financial instruments that existed during the comparative period but were derecognised before the date of initial application. They suggested the Board amend IFRS 9 to allow entities a choice of applying IFRS 9 or IAS 39 to such financial instruments. The Board observed that the transition requirements in IFRS 9 respond to requests from stakeholders made when IFRS 9 was being developed. Adding a further option to the transition requirements in IFRS 9 after the mandatory effective date of that Standard would result in reduced

© IFRS Foundation

comparability and could have unintended consequences. Accordingly, the Board did not agree with this suggestion.

Transition modifications and reliefs (paragraphs C3(b), C5A, C9A and C22A)

BC119 The Exposure Draft proposes amendments that would provide additional transition modifications and reliefs for entities applying IFRS 17 for the first time for:

(a) the classification of contracts acquired in their settlement period (paragraphs BC120–BC124); and

(b) the risk mitigation for insurance contracts with direct participation features (paragraphs BC125–BC133).

Classification of contracts acquired in their settlement period

Proposed amendment

BC120 Liabilities that relate to the settlement of claims for insured events are generally treated as liabilities for incurred claims. However, if an entity acquires the insurance contract after the insured event occurred and the amount for which it will be settled is uncertain, IFRS 17 requires an entity to classify the liability that relates to the settlement of claims for that insured event as a liability for remaining coverage. For the acquiring entity, the insured event is the determination of the ultimate cost of those claims.

BC121 Paragraph C9A of the Exposure Draft proposes an additional modification to the modified retrospective approach that would permit an entity to classify such liabilities for insurance contracts acquired before the transition date as a liability for incurred claims rather than a liability for remaining coverage. Consistent with the other requirements for the modified retrospective approach, an entity would be permitted to apply this modification only to the extent that it does not have reasonable and supportable information to apply a retrospective approach. Paragraph C22A of the Exposure Draft proposes that an entity applying the fair value approach would have an option to classify such a liability as a liability for incurred claims.

BC122 No additional disclosures are proposed as a result of the proposed amendments in paragraphs C9A and C22A of the Exposure Draft. Paragraph 115 of IFRS 17 requires an entity to explain how it determined the measurement of insurance contracts at the transition date to enable users of financial statements to understand the nature and significance of the methods used and judgements applied in determining the transition amounts.

Rationale for changing the requirements

BC123 The Board set the requirements in the modified retrospective approach to achieve the closest outcome to retrospective application possible using reasonable and supportable information available without undue cost or effort. Each modification addresses specific areas of the requirements the Board expected would often be impracticable to apply retrospectively.

BC124 Since IFRS 17 was issued, the Board has heard that it will often be impracticable for an entity to classify contracts acquired in their settlement period before the transition date as either a liability for remaining coverage or a liability for incurred claims. At the time those contracts were acquired, the entity may have managed the claims for those contracts with other contracts it issued and may have gathered data at a higher level than is required to distinguish between claims from contracts issued and claims from contracts acquired. The Board noted that the existing requirements in the modified retrospective approach and reliefs in the fair value approach do not resolve this challenge. Accordingly, the Board concluded that a new specific modification and new relief should be proposed for transition to IFRS 17.

Risk mitigation for insurance contracts with direct participation features

Proposed amendment

BC125 Paragraph B115 of IFRS 17 allows an entity an accounting policy choice to reflect some or all of the changes in the effect of financial risk on insurance contracts with direct participation features that usually adjust the contractual service margin immediately in profit or loss. An entity can apply the option if, and only if, the entity mitigates those financial risks using derivatives and meets the conditions in paragraph B116 of IFRS 17 (or mitigates those financial risks using reinsurance contracts held applying the proposed amendment in paragraph B116 of the Exposure Draft). Applying paragraph C3(b) of IFRS 17, an entity is not permitted to apply the risk mitigation option for periods before the date of initial application, because the Board concluded that doing so would give rise to the risk of the use of hindsight.

BC126 The Exposure Draft proposes two amendments to the transition requirements relating to the risk mitigation option:

(a) the proposed amendment to paragraph C3(b) of IFRS 17 would permit an entity to apply the option in paragraph B115 of IFRS 17 prospectively from the transition date, rather than the date of initial application. To apply the option in paragraph B115 of IFRS 17 from the transition date, an entity would be required to designate risk mitigation relationships at or before the transition date.

(b) paragraph C5A of the Exposure Draft proposes that an entity that can apply IFRS 17 retrospectively to a group of insurance contracts would be permitted to instead apply the fair value approach to that group if, and only if:

  (i) the entity chooses to apply the risk mitigation option in paragraph B115 of IFRS 17 to the group prospectively from the transition date; and

  (ii) before the transition date, the entity has been using derivatives or reinsurance contracts held to mitigate financial risk arising from the group of insurance contracts.

© IFRS Foundation

BC127 The Board concluded that additional disclosures as a result of those amendments would not be needed because the disclosures in paragraphs 114–116 of IFRS 17 already require an entity to explain how it determined the measurement of insurance contracts at the transition date.

Rationale for changing the requirements

BC128 Some stakeholders stated that permitting retrospective application of the risk mitigation option in paragraph B115 of IFRS 17 would enhance comparability of information before and after the date of initial application of IFRS 17. In the Board's view, permitting an entity to apply the risk mitigation option consistently for risk mitigation activities that take place before and after the date of initial application of IFRS 17 could increase comparability between reporting periods and, therefore, provide users of financial statements with useful information. However, as the risk mitigation option can be applied to particular risks in a group of insurance contracts, permitting application of the option retrospectively would risk the use of hindsight and create opportunities for entities to decide the risk mitigation relationships to which to apply the option based on the known accounting outcome. Accordingly, the Board disagreed with a suggestion by stakeholders that an entity should be permitted to apply the risk mitigation option retrospectively.

BC129 Despite concluding that an entity should not be allowed to apply the risk mitigation option retrospectively, the Board sought to address stakeholders' concerns about a lack of consistency in the treatment of risk mitigation activities before and after the date of initial application of IFRS 17. The Board noted that the risk mitigation option is a choice and so an entity could avoid this inconsistency. However, the Board understood that some entities want to use the risk mitigation option, as intended, to address the accounting mismatch between insurance contracts with direct participation features and derivatives that meet specified conditions. As a result, the Board considered whether an alternative approach would allow an entity to avoid the mismatch without risking the use of hindsight.

BC130 The Board concluded it should be possible for an entity to apply the risk mitigation option from a date earlier than the date of initial application of IFRS 17 without risking the use of hindsight. Accordingly, to address concerns about inconsistency between the first reporting period applying IFRS 17 and the restated comparative information, the Board decided to allow an entity to apply the risk mitigation option in the comparative period if it does so prospectively. Applying the option prospectively requires the entity to designate the risk mitigation relationships to which it will apply the option at or before the transition date.

BC131 The Board also noted that an entity that uses the fair value transition approach in IFRS 17 avoids the situation in which changes in the fair value of derivatives being used for risk mitigation are reflected in opening retained earnings or equity but the corresponding changes in the insurance contracts are reflected in the contractual service margin. At the transition date, the fair value of derivatives will include only expectations about future cash flows. In the fair value approach, the fair value of insurance contracts at transition

would also include only expectations about future cash flows. Any past gains or losses on derivatives and any effects on insurance contracts of past changes in financial risk would be reflected in opening retained earnings. However, applying the existing requirements in IFRS 17, an entity is only permitted to apply the fair value approach if it is impracticable to apply IFRS 17 retrospectively.

BC132 In the Board's view, applying IFRS 17 retrospectively provides the most useful information about insurance contracts both on transition to IFRS 17, and in future reporting periods. However, the Board concluded that the loss of information would be acceptable if entities with risk mitigation activities were permitted to apply the fair value approach instead of retrospective application. The Board noted that those entities are unable to apply a full retrospective approach because paragraph C3(b) of IFRS 17 prohibits them from applying paragraph B115 of IFRS 17. Furthermore, the Board views the fair value approach as also providing useful information. However, the Board decided to limit the groups of insurance contracts to which this proposed amendment could apply, because it is intended to address only contracts for which stakeholders' concerns relating to risk mitigation apply.

BC133 The Board considered a suggestion by stakeholders to amend IFRS 17 to permit an entity to apply the risk mitigation option in paragraph B115 of IFRS 17 retrospectively if, and only if, the entity applies the option for all risk mitigation relationships that would meet the conditions in paragraph B116 of IFRS 17. While in principle this would address the concern about opportunistic selection, the Board concluded that such an amendment would not be appropriate because it would not be possible to assess the completeness of such an approach in practice. Historically, no other IFRS Standard has required an entity to document such risk mitigation relationships as specified in paragraph B116 of IFRS 17.

Other transition amendments considered and rejected

BC134 The Board did not accept the following amendments suggested by stakeholders to address their concerns and challenges on transition to IFRS 17:

(a) reduce the options available on transition to IFRS 17 (paragraphs BC135–BC136);

(b) change accumulated other comprehensive income on transition (paragraphs BC137–BC138); and

(c) extend the modified retrospective approach by:

    (i) removing the requirements to use reasonable and supportable information (paragraphs BC139–BC141);

    (ii) permitting an entity to develop its own additional modifications (paragraphs BC142–BC143);

    (iii) changing the modification for cash flows known to have occurred (paragraph BC144); and

 © IFRS Foundation

(iv) changing the modification for insurance contracts with direct participation features (paragraphs BC145–BC146).

Reducing the options available on transition to IFRS 17

BC135 Applying paragraph C5 of IFRS 17, an entity can choose between applying the modified retrospective approach or the fair value approach to a group of insurance contracts if, and only if, full retrospective application is impracticable. In addition, applying the fair value approach, an entity is permitted choices regarding specified aspects of the requirements. Some stakeholders expressed concerns about the reduced comparability that results from optionality in the transition requirements. The Board acknowledged that optionality in the transition requirements results in a lack of comparability. However, the Board concluded that the choices provided are appropriate. Allowing a choice between the modified retrospective approach and the fair value approach when retrospective application is impracticable enables entities to achieve a close outcome to retrospective application using reasonable and supportable information available without undue cost or effort. However, if an entity would need to use many of the permitted modifications in the modified retrospective approach, the cost of applying that approach might exceed the benefit, compared to the use of the fair value approach.

BC136 In the Board's view, providing practical one-off reliefs to help entities with their transition to IFRS 17 is worth a limited loss of comparability for a limited period. Accordingly, the Board disagreed with suggestions to reduce the options available in the transition requirements because doing so would likely cause undue disruption at this stage of implementation. The Board noted the reduced comparability caused by the transition options does not affect the current value measurement of the fulfilment cash flows. The Board further noted that entities are required to provide disclosures on the transition approaches used to assist users of financial statements to make comparisons between entities and to understand the transition reliefs used and how they affect reported information.

Changing accumulated other comprehensive income on transition

BC137 Paragraphs 88–89 of IFRS 17 permit an entity to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income. The Board decided to include in IFRS 17 a simplification for determining the amount accumulated in other comprehensive income on transition, by permitting or requiring an entity to assume that amount is nil, provided specified criteria are met. Some stakeholders suggested that on transition there should be an amount accumulated in other comprehensive income for financial assets, to correspond to the amount accumulated in other comprehensive income for insurance contracts. Stakeholders suggested the following approaches:

(a) to deem as nil the accumulated amount in other comprehensive income for financial assets accounted for applying IFRS 9 that are related to insurance contracts.

(b) to deem the accumulated amount of insurance finance income or expenses in other comprehensive income as equal to the accumulated amount in other comprehensive income arising on financial assets accounted for applying IFRS 9 that are related to insurance contracts. This approach would be similar to the requirement in paragraph C19(b)(iv) of IFRS 17 for insurance contracts with direct participation features, which requires an entity to deem the accumulated amount in other comprehensive income as equal to the cumulative amount recognised in other comprehensive income on the underlying items.

BC138 The Board disagreed with the suggestion in paragraph BC137 that it should amend the transition requirements in IFRS 9 or IFRS 17 because:

(a) both suggested amendments involve potential subjectivity in determining which assets relate to insurance contracts.

(b) both suggested amendments could result in an outcome that the Board would not consider to be sufficiently close to retrospective application of IFRS 17 requirements.

(c) the suggested amendment to IFRS 9 described in BC137(a) would reduce comparability between insurers that would choose this approach and other entities that have already applied IFRS 9. The Board also noted that the amount accumulated in other comprehensive income relating to financial assets measured at fair value through other comprehensive income includes amounts that relate to expected credit losses. Hence, setting the cumulative amount to nil on transition would affect the accounting for expected credit losses in future periods.

(d) the suggested amendment to IFRS 17 described in BC137(b) would mean that insurance finance income or expenses recognised in profit or loss in future periods would reflect the historical discount rate for those assets held at the transition date that the entity determines are related to insurance contracts. In the Board's view, using that historical discount rate could result in a significant loss of useful information because of the potential subjectivity in determining which assets relate to insurance contracts and because comparability for insurance contracts would be reduced between entities that hold different assets.

Using the modified retrospective approach

Removing the requirements to use reasonable and supportable information

BC139 To achieve the objective of the modified retrospective approach, an entity is permitted to use each modification in paragraphs C9–C19 of IFRS 17 only to the extent that it lacks reasonable and supportable information for applying a retrospective approach. To use each modification, an entity must have the reasonable and supportable information necessary to apply that modification.

© IFRS Foundation

If not, the entity is required to apply the fair value approach to the group of insurance contracts.

BC140 Some stakeholders suggested that to provide additional operational relief on transition an entity using the modified retrospective approach should be permitted to use any of the modifications available in that approach, even if it could apply the related IFRS 17 requirements retrospectively. The Board acknowledged that this suggestion could provide a significant cost relief. However, the Board observed that this optionality would be contrary to the objective of the modified retrospective approach. Applying aspects of IFRS 17 retrospectively maximises comparability between contracts issued before and after the transition date.

BC141 Some stakeholders suggested an entity using the modified retrospective approach should be permitted to use a modification without assessing whether it has reasonable and supportable information to apply that modification. Such an amendment would remove the burden of demonstrating that the information used to apply a modification is reasonable and supportable. The Board disagreed with this suggestion because in its view, entities should use information that is reasonable and supportable.

Permitting an entity to develop its own modifications

BC142 The modifications in paragraphs C9–C19 of IFRS 17 provide approximations to retrospective application. Some stakeholders suggested that an entity should be permitted to develop its own modifications that the entity thinks would achieve the closest possible outcome to retrospective application. The Board disagreed with this suggestion because if this were to be permitted:

(a) an entity could use modifications that would result in an outcome that the Board would not consider to be sufficiently close to retrospective application. The Board noted that it was willing to consider stakeholder suggestions for additional specific modifications, and that the only specific modification suggested was in relation to insurance contracts acquired in their settlement period (see proposed amendment discussed in paragraphs BC120–BC124).

(b) entities could use different modifications, which would reduce comparability and increase complexity for users of financial statements.

BC143 The Board noted that some stakeholders made this suggestion because they incorrectly thought the inclusion of specified modifications in IFRS 17 implies that an entity cannot make estimates in applying IFRS 17 retrospectively. The Board noted that paragraph 51 of IAS 8 specifically acknowledges the need for estimates in retrospective application and that this paragraph applies to entities applying IFRS 17 for the first time just as it does to entities applying other IFRS Standards for the first time. The Board also noted that it expects that estimates will often be needed when applying a specified modification in the modified retrospective approach.

Changing the modification for cash flows that are known to have occurred

BC144 Paragraph C12 of IFRS 17 provides a modification for estimating future cash flows at the date of initial recognition of a group of insurance contracts. Some stakeholders expressed concerns that this modification requires an entity to identify the exact amount of actual cash flows that are known to have occurred, which would often be impracticable or at least burdensome to do. The Board concluded an amendment is not necessary to address these concerns. As explained in paragraph BC143, the Board expects that estimates will often be needed when applying a specified modification in the modified retrospective approach.

Changing the modification for insurance contracts with direct participation features

BC145 Paragraph C17 of IFRS 17 provides a modification for determining the contractual service margin at the transition date for insurance contracts with direct participation features. That modification determines the carrying amount of the contractual service margin at the transition date in a more direct way than the modifications in paragraphs C11–C16 of IFRS 17. It is possible to determine the contractual service margin in this more direct way because of the extent to which the contractual service margin is remeasured in the variable fee approach.

BC146 Some stakeholders suggested that an entity should be able to apply the modifications in paragraphs C11–C16 of IFRS 17 to insurance contracts with direct participation features. The Board disagreed with this suggestion because it is highly unlikely that applying those modifications to such contracts would achieve an outcome as close to retrospective application as would applying paragraph C17 of IFRS 17.

Minor amendments

BC147 In addition to the proposed amendments described in paragraphs BC9–BC146, the Board proposes minor amendments to address a number of cases in which the drafting of IFRS 17 does not achieve the Board's intended outcome. The Board has not, and does not intend to, perform a comprehensive review of possible drafting improvements. Paragraphs BC149–BC163 explain each of the minor amendments proposed in the Exposure Draft.

BC148 In addition, the Board identified a number of editorial corrections to IFRS 17 that have been included in the Exposure Draft, for example:

(a) a change has been made to paragraph 27 of IFRS 17 to delete 'or liability' for insurance acquisition cash flows paid before the related group of insurance contracts is recognised, because such an amount is always an asset; and

(b) changes have been made to paragraphs 45, 48, 50, B104, B112 and B115 of IFRS 17 so that the Standard consistently refers to 'change in the amount of the entity's share of the fair value of the underlying items'.

 © IFRS Foundation

Scope and investment contracts with discretionary participation features (paragraph 11(b) of IFRS 17)

BC149 Paragraph 11(b) of IFRS 17 requires an entity to separate an investment component from a host insurance contract and apply IFRS 9 to the separated investment component if, and only if, that investment component is distinct. The Exposure Draft proposes to clarify that if the separated component meets the definition of an investment contract with discretionary participation features, that component should be accounted for applying IFRS 17.

Recognition of contracts within a group (paragraph 28 of IFRS 17)

BC150 Paragraph 28 of IFRS 17 requires that in recognising a group of insurance contracts in a reporting period, an entity shall include only contracts issued by the end of the reporting period. The Exposure Draft proposes that 'contracts issued by the end of the reporting period' is replaced with 'contracts that meet the criteria for recognition in paragraph 25' to clarify that insurance contracts are added to a group when they meet the recognition criteria (which may or may not be when those contracts are issued). The Exposure Draft also proposes a consequential amendment to paragraph 24 of IFRS 17. In response to questions from stakeholders, the Board confirmed that, in contrast to paragraph 28 of IFRS 17, the intention of paragraph 22 of IFRS 17 is to refer to the time at which insurance contracts are issued, rather than recognised. Therefore, the Board is not proposing to amend paragraph 22 of IFRS 17.

Business combinations outside the scope of IFRS 3 (paragraphs B93–B95 of IFRS 17)

BC151 Paragraph 39 of IFRS 17 requires an entity to apply specific requirements when determining the contractual service margin for insurance contracts acquired in a transfer of insurance contracts or a business combination. The Exposure Draft proposes that 'business combination' is replaced with 'business combination in the scope of IFRS 3' in paragraphs B93–B95 of IFRS 17 to clarify that the measurement requirements in those paragraphs are not required to be applied to insurance contracts acquired in business combinations outside the scope of IFRS 3, for example, business combinations under common control.

Adjusting the loss component for changes in the risk adjustment for non-financial risk (paragraphs 48(a) and 50(b) of IFRS 17)

BC152 Paragraphs 47–52 of IFRS 17 require the identification of a loss component that depicts the extent to which a group of insurance contracts is onerous. The determination of the loss component includes the effect of the risk adjustment for non-financial risk; however, paragraphs 48(a) and 50(b) of IFRS 17 refer only to changes in estimates of future cash flows and not to the risk adjustment for non-financial risk. The Exposure Draft proposes to clarify that the requirements in paragraphs 48(a) and 50(b) of IFRS 17 relate to both changes in estimates of future cash flows and changes in the risk adjustment for non-financial risk.

© IFRS Foundation

Disclosure of investment components excluded from insurance revenue and insurance service expenses (paragraph 103(c) of IFRS 17)

BC153 Paragraph 100 of IFRS 17 requires disclosure of a reconciliation from the opening to the closing balances of the insurance contract liability. Paragraph 103(c) of IFRS 17 requires an entity to separately disclose in that reconciliation investment components excluded from insurance revenue and insurance service expenses. The Exposure Draft proposes to clarify that an entity is not required to disclose refunds of premiums separately from investment components in the reconciliation required by paragraph 100 of IFRS 17.

Risk adjustment for non-financial risk in disclosure requirements (paragraphs 104, B121 and B124 of IFRS 17)

BC154 Paragraph 104 of IFRS 17 on disclosing amounts related to insurance contract services and paragraphs B121 and B124 of IFRS 17 on insurance revenue identify the risk adjustment for non-financial risk separately from other amounts. However, some amounts included in the measurement of the risk adjustment for non-financial risk could be captured in other components described in those paragraphs. The Exposure Draft proposes that ‘excluding amounts relating to the risk adjustment for non-financial risk’ is added to the descriptions of the other components in those paragraphs to prevent potential double counting.

Disclosure of sensitivity analyses (paragraphs 128–129 of IFRS 17)

BC155 Paragraphs 128–129 of IFRS 17 provide disclosure requirements for sensitivity analyses on insurance risks and market risks. The Exposure Draft proposes that ‘risk exposure’ in paragraphs 128–129 of IFRS 17 is replaced with ‘risk variable’ to correct the terminology used.

Definition of an investment component (Appendix A of IFRS 17)

BC156 Appendix A of IFRS 17 defines an investment component as the amounts an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur. Paragraph BC34 of the Basis for Conclusions on IFRS 17 explains that the investment component is an amount paid to the policyholder in all circumstances. That explanation is not entirely captured by the wording in the definition. The Exposure Draft proposes that the definition in Appendix A of IFRS 17 is amended to clarify the Board’s intention that an investment component is the amount an insurance contract requires the entity to repay to a policyholder in all circumstances, regardless of whether an insured event occurs.

 © IFRS Foundation

Excluding changes relating to the time value of money and assumptions that relate to financial risk from changes in the carrying amount of the contractual service margin (paragraph B96(c) of IFRS 17)

BC157 Paragraph B96(c) of IFRS 17 requires changes in fulfilment cash flows that arise from differences between any investment component expected to become payable in the period and the actual investment component that becomes payable in the period to adjust the contractual service margin. The Exposure Draft proposes to clarify that paragraph B96(c) of IFRS 17 does not apply to the differences described in paragraph B97(a) of IFRS 17. An entity is required to recognise in profit or loss or other comprehensive income changes relating to the time value of money and assumptions that relate to financial risk.

Changes in the risk adjustment for non-financial risk (paragraph B96(d) of IFRS 17)

BC158 Applying paragraph 81 of IFRS 17, an entity is not required to disaggregate the change in the risk adjustment for non-financial risk between the insurance service result and insurance finance income or expenses. If an entity does not provide such a disaggregation, it includes the entire change in the risk adjustment for non-financial risk as part of the insurance service result. Paragraph B96(d) of IFRS 17 does not address the treatment of changes in the risk adjustment for non-financial risk caused by the time value of money if they are disaggregated. The Exposure Draft proposes to clarify that if an entity makes such a disaggregation, it shall adjust the contractual service margin only for the changes related to non-financial risk, measured at the discount rates specified in paragraph B72(c) of IFRS 17.

Use of the risk mitigation option (paragraph B118 of IFRS 17)

BC159 Paragraph B118 of IFRS 17 states that an entity shall cease to apply the risk mitigation option in paragraph B115 of IFRS 17 from the date the conditions in paragraph B116 of IFRS 17 cease to be met. The Exposure Draft proposes to clarify that an entity ceases to apply paragraph B115 of IFRS 17 for a group of insurance contracts if, and only if, the conditions in paragraph B116 of IFRS 17 cease to be met. This clarification is consistent with IFRS 9 which does not allow an entity to discontinue hedge accounting unless the hedging relationship ceases to meet the qualifying criteria.

Excluding changes from cash flows relating to loans to policyholders from revenue (paragraph B123 of IFRS 17)

BC160 Some contracts in the scope of IFRS 17 include a loan component (that is, the entity lends amounts to the policyholder and expects the policyholder to repay the entity later). The payment or receipt of amounts lent to and repaid by policyholders does not give rise to insurance revenue. Paragraph B123 of IFRS 17 does not exclude these amounts from the changes in the liability for remaining coverage that give rise to insurance revenue. The Exposure Draft proposes an additional exclusion in paragraph B123(a) of IFRS 17 to clarify that changes caused by cash flows from loans to policyholders do not give rise

to insurance revenue. Any waiver of a loan to a policyholder would be treated in the same way as any other claim.

Treatment of changes in underlying items (paragraph B128 of IFRS 17)

BC161 Paragraph 87 of IFRS 17 requires an entity to include in insurance finance income or expenses the effect of changes in assumptions that relate to financial risk. The Exposure Draft proposes an amendment to paragraph B128 of IFRS 17 to clarify that changes in the measurement of a group of insurance contracts caused by changes in underlying items are changes arising from the effect of the time value of money and assumptions that relate to financial risk for the purposes of IFRS 17. Otherwise, changes in underlying items could adjust the contractual service margin of insurance contracts without direct participation features.

Amendment to IFRS 3 *Business Combinations* (Appendix D of the Exposure Draft)

BC162 Paragraph 15 of IFRS 3 requires an acquirer to classify assets acquired and liabilities assumed based on the terms and conditions as they exist at the acquisition date. As a relief, paragraph 17(b) of IFRS 3 provided an exception to that requirement for insurance contracts in the scope of IFRS 4. That exception required an acquirer to classify insurance contracts based on the contractual terms and other factors at the inception of the contract, rather than at the acquisition date. That exception will no longer apply when an entity applies IFRS 17; an acquirer of an insurance contract will apply the requirements in paragraph 15 of IFRS 3 as would the acquirer of any other contract. The Exposure Draft proposes an amendment to paragraph 64N of IFRS 3 to clarify that an entity can continue to use the exception in paragraph 17(b) of IFRS 3 for business combinations that occurred before the date of initial application of IFRS 17.

Amendment to IFRS 7 *Financial Instruments: Disclosures*, IFRS 9 *Financial Instruments* and IAS 32 *Financial Instruments: Presentation* (Appendix D of the Exposure Draft)

BC163 IFRS 17 amended the scope of IFRS 7, IFRS 9 and IAS 32 to refer to contracts within the scope of IFRS 17 rather than insurance contracts as defined by IFRS 4. The Exposure Draft proposes replacing the words ‘contracts within the scope of IFRS 17’ in those Standards with ‘insurance contracts as defined in IFRS 17 and investment contracts with discretionary participation features within the scope of IFRS 17’ to clarify that, consistent with the scope of these Standards before IFRS 17 was issued, insurance contracts held are not in the scope of IFRS 7, IFRS 9 and IAS 32.

 © IFRS Foundation

Areas the Board considered and for which amendments to IFRS 17 are not proposed

Level of aggregation (paragraphs 14–24 of IFRS 17)

BC164 Generally, IFRS Standards require an entity to account separately for each contract to which the entity is a party. For insurance contracts, as for other types of contracts, an entity's rights and obligations are created by each contract it enters with each customer. However, as an exception to the general approach in IFRS Standards, IFRS 17 does not require measurement of individual contracts. This reflects the Board's view that measuring individual insurance contracts would not provide useful information about insurance activities, which often rely on an entity issuing many similar contracts to reduce risk.

BC165 On the other hand, measuring insurance contracts at too high a level of aggregation could obscure information about profitability that the Board regards as fundamentally important. In particular, the Board's key objectives for IFRS 17 are to require entities to provide improved information about profitability by requiring entities to:

(a) recognise profit on profitable contracts as services are provided;

(b) recognise losses on onerous contracts as soon as the entity determines that losses are expected; and

(c) report timely information about changes in profitability.

BC166 In the Board's view, the information described in paragraph BC165 results in more transparent and, therefore, useful information than does averaging profits or losses between contracts or averaging different levels of profit over time. The Board expects that transparency in reporting profits and losses and changes in profitability over time will contribute to improving users of financial statements understanding of insurance activities and long-term financial stability by providing useful information that will enable timely decisions by users of financial statements. Feedback from users of financial statements before and since IFRS 17 was issued supports this view.

BC167 Accordingly, to provide useful information about the profitability of insurance contracts, while acknowledging the practical considerations raised by stakeholders, the Board developed the level of aggregation requirements in paragraphs 14–24 of IFRS 17. Those requirements strike the best possible balance between the need to aggregate insurance contracts to provide useful information about insurance activities which often rely on an entity issuing a number of similar contracts to reduce risk, limiting the loss of useful information for users of financial statements and providing a significant practical relief for entities that will need to maintain data at a more granular level to apply IFRS 17 than they otherwise would.

BC168 The Board acknowledged that this approach may result in some loss of useful information about the profitability of insurance contracts because they already include practical compromises that may give rise to the risks of averaging profits over a limited period and of averaging losses with profits. The Board set the requirements to limit that loss of information to a degree that the Board concluded was acceptable. The Board observed that, while developing IFRS 17, it had developed a principle-based approach to grouping insurance contracts to reflect similar profitability and similar coverage periods. In the Board's view, that approach would have provided the most useful information. However, stakeholders interpreted that principle-based approach as requiring an excessively granular level of information, and hence regarded it as burdensome. Stakeholders also indicated that those requirements would result in considerable diversity in practice. Responding to this feedback, the Board withdrew the approach.

BC169 Consistent with the feedback the Board considered during the development of IFRS 17, some stakeholders expressed concerns about the level of aggregation requirements. Those stakeholders suggested the Board amend IFRS 17 to:

(a) replace the level of aggregation requirements with approaches that reflect an entity's internal management (see paragraph BC171);

(b) reduce the minimum number of profitability buckets as specified in paragraph 16 of IFRS 17 from three to two (contracts that are onerous at initial recognition and contracts that are not onerous at initial recognition) (see paragraph BC172); and

(c) remove, or exempt some groups of insurance contracts from, the annual cohort requirement in paragraph 22 of IFRS 17 (see paragraphs BC173–BC179).

BC170 After reconsidering stakeholders' concerns set out in paragraphs BC171–BC179, the Board reaffirmed its view that the benefits of the existing requirements outweigh the costs and concluded that any further relief that the Board could provide entities to ease their operational burden would be likely to significantly reduce the benefits introduced by IFRS 17.

Reflecting internal management approaches

BC171 Some stakeholders suggested the Board amend IFRS 17 to replace all level of aggregation requirements in paragraphs 14–24 of IFRS 17 with approaches that reflect an entity's internal management, which in the stakeholders' view would be a principle-based approach. The Board disagreed with this suggestion because the objective of the level of aggregation requirements is to provide users of financial statements with useful and timely information about periodic financial performance. Internal management approaches, for example, an entity's asset and liability management strategy or risk management strategy, have their own objectives and would not necessarily meet the Board's objectives, as described in paragraph BC165.

 © IFRS Foundation

Minimum profitability buckets

BC172 Some stakeholders suggested the Board amend IFRS 17 to reduce the minimum number of profitability buckets from three to two (contracts that are onerous at initial recognition and contracts that are not onerous at initial recognition). That suggested amendment would remove the requirement to group separately insurance contracts that at initial recognition have no significant possibility of becoming onerous from other insurance contracts that are not onerous at initial recognition. In the Board's view, further distinguishing contracts that are not onerous at initial recognition into those two groups provides useful information because losses on groups of contracts that subsequently become onerous are recognised on a more timely basis. In many circumstances, an entity will not issue contracts expecting them to be onerous. Rather, onerous losses arise from subsequent changes in expectations about groups of contracts that were initially expected to be profitable. Having only one profitability bucket for all contracts that are profitable on initial recognition would increase the amount of averaging that occurs and the risk of losses arising on contracts that are not resilient to adverse changes in expectations being absorbed by profits arising on contracts that are more resilient to adverse changes in expectations. This could significantly delay loss recognition or result in losses for onerous contracts never being recognised. For those reasons, the Board rejected stakeholders' suggestions to reduce the minimum number of profitability buckets from three to two.

Annual cohorts

BC173 Some stakeholders suggested the Board amend IFRS 17 to remove the requirements for annual cohorts if an entity has reasonable and supportable information to conclude that contracts issued more than one year apart would be classified in the same profitability bucket. The Board disagreed with this suggestion because it could result in a portfolio consisting of only three groups that would last for the entire life of the portfolio, which may be indefinite. The contractual service margin of each group would average the profitability of all contracts in the group over the life of the portfolio. Furthermore, the contracts placed in any of the three profitability groups could be significantly more or less profitable than other contracts in the group. This means the effect of averaging profits across the contracts in the group could be substantially increased, leading to a greater possibility that:

(a) the contractual service margin of a contract would outlast the coverage period of that contract (that is, the period when the entity provides service); and

(b) the continuing profitability of some contracts would absorb the subsequent adverse changes in expectations that make some contracts onerous, resulting in the loss of useful information about trends in profitability.

BC174 Some stakeholders expressed the view that, in some circumstances, they could achieve, at much less cost, the same or a similar outcome without applying the annual cohort requirement in paragraph 22 of IFRS 17 as would be achieved applying that requirement. In addition, some stakeholders suggested

the Board amend IFRS 17 to exempt groups of contracts in the scope of the variable fee approach or groups of contracts that share returns on underlying items across generations from the annual cohort requirement in paragraph 22 of IFRS 17. Proponents of this approach explained that, in their view, applying paragraph 22 of IFRS 17 to some groups of contracts that share returns on underlying items across generations is unnecessary because, in some cases, a group is only ever onerous if the entire portfolio is onerous. They regard the separate identification of the contractual service margin for annual cohorts in these circumstances as unduly costly and think it provides information that is not useful because in their view:

(a) it is arbitrary; and

(b) it potentially attributes changes in the fair value of the underlying items to an inappropriately narrow set of annual cohorts.

BC175 The Transition Resource Group for IFRS 17 discussed examples of groups of contracts that share returns on underlying items across generations and observed that when groups of insurance contracts fully share risks (that is, contracts share in 100 per cent of the return on a pool of underlying items), the contractual service margin will be nil. Therefore, as explained in paragraph BC138 of the Basis for Conclusions on IFRS 17, measuring the contractual service margin at a higher level than the annual cohort level would achieve the same accounting outcome as measuring the contractual service margin at an annual cohort level. The Board disagreed with stakeholders' suggestions that IFRS 17 should be amended to reflect such circumstances because, in the Board's view, making that amendment is unnecessary. The Board reaffirmed its position that, as explained in paragraph BC138 of the Basis for Conclusions on IFRS 17, the requirements specify the amounts to be reported, not the methodology to be used to arrive at those amounts. An entity would be required to apply judgement in concluding whether it could achieve the same accounting outcome without annual cohorts, including considering whether profitability is the same considering all possible scenarios for future expectations.

BC176 The Transition Resource Group for IFRS 17 also discussed examples of groups of contracts when contracts share to a lesser extent in the return on a pool of underlying items (that is, less than 100 per cent). In contrast to the examples described in paragraph BC175, in these examples the entity could be affected by the expected cash flows of each contract issued because the contracts do not fully share risks. Therefore, for those contracts, the contractual service margin at a group level may differ from the contractual service margin at a higher level than the group.

BC177 The Board observed that intergenerational sharing of returns between policyholders is reflected in the fulfilment cash flows and, therefore, also reflected in the contractual service margin of each generation of contracts applying paragraphs B67–B71 of IFRS 17. However, this does not necessarily mean each generation of contracts is equally profitable for the entity. Accordingly, removing the requirement for annual cohorts for those groups of

 © IFRS Foundation

contracts would average higher or lower profits across generations, resulting in a loss of information about profitability over time.

BC178 Furthermore, the Board does not think the separate identification of the contractual service margin for each annual cohort is arbitrary. The contractual service margin for each annual cohort includes the changes in fulfilment cash flows allocated to the annual cohort and the entity's share of the change in the fair value returns of the underlying items. Even if the policyholders across all annual cohorts share equally in the fair value returns, the amount of the entity's share in those returns created by each annual cohort may differ, reflecting the contractual terms and the economic conditions during the coverage period of each annual cohort. For example, an entity's share of 20 per cent of the fair value returns of underlying items is a higher amount for annual cohorts for which the coverage period includes periods in which the fair value returns are 5 per cent than it is for annual cohorts for which the coverage period includes only periods in which the fair value returns are 1 per cent.

BC179 The Board accepts that identifying the contractual service margin at the annual cohort level may incur costs. However, the Board continues to hold the view that information about higher or lower profits earned by the entity from different generations of contracts is sufficiently useful information to justify such costs.

Cash flows in the boundary of a reinsurance contract held (paragraphs 34 and B61–B66 of IFRS 17)

BC180 IFRS 17 requires an entity to include in the measurement of a group of insurance contracts issued (or reinsurance contracts held) all future cash flows within the boundary of each contract in the group. An entity estimates future cash flows for insurance contracts based on the expected value of the full range of possible outcomes. For a reinsurance contract held, that estimate of future cash flows will include future cash flows that relate to all insurance contracts the entity expects to be covered by the reinsurance contract held, including future insurance contracts the entity expects to issue. Some stakeholders suggested the Board amend the contract boundary requirements for reinsurance contracts held. The stakeholders' suggested amendments would require cash flows of the reinsurance contract held that relate to underlying insurance contracts that have not yet been issued to be excluded from the measurement of the reinsurance contract held until those underlying insurance contracts are issued.

BC181 The Board noted that the suggestions by stakeholders, which are consistent with feedback the Board received during the development of IFRS 17, would achieve an outcome similar to the practice often used applying IFRS 4, whereby an entity measures reinsurance contracts held based on the measurement of the underlying insurance contracts. The Board reaffirmed its view that the accounting for a reinsurance contract held should be consistent with the accounting for insurance contracts issued. Such accounting includes measuring the expected value of all the entity's rights and obligations from a contract independently of the expected value of the entity's rights and

obligations from other contracts. An entity's rights and obligations as the holder of a reinsurance contract differ from its rights and obligations as the issuer of underlying insurance contracts. When an entity holds a reinsurance contract that covers insurance contracts it expects to issue in the future, the entity has a substantive right to receive reinsurance coverage for those future insurance contracts. In contrast, the entity has no substantive rights or substantive obligations to policyholders under the future insurance contracts.

BC182 Some stakeholders expressed the view that the requirements in IFRS 17 create an accounting mismatch because expected future cash flows related to insurance contracts expected to be issued may be reflected in determining the contractual service margin of a reinsurance contract held before those underlying insurance contracts are issued. The Board observed that the measurement of the carrying amount of the reinsurance contract held and the underlying insurance contracts does not create an accounting mismatch. If the reinsurance contract held is recognised before some of the underlying insurance contracts are recognised and no cash flows have been paid or received relating to the reinsurance of those underlying contracts, the carrying amount of the reinsurance contract held will include all the expected cash inflows and cash outflows relating to the reinsurance of those future underlying contracts. The difference between the cash inflows and cash outflows (adjusted for non-financial risk) on initial recognition of the reinsurance contract held is recognised as a contractual service margin in the carrying amount of the reinsurance contract held asset. Before any cash flows occur and any service is received, the carrying amount of the reinsurance contract held is, therefore, zero.

BC183 Differences between the carrying amount of the reinsurance contract held and the underlying insurance contracts will arise because of differences in the provision of coverage and differences in the timing of cash flows, if any. Often insurance coverage under the reinsurance contract held will be received at the same time as insurance coverage is provided by the underlying insurance contracts, so will not create a difference in carrying amount. Differences in carrying amounts caused by different timings of cash flows are not accounting mismatches. Interest may be accreted on the contractual service margin of the reinsurance contract held from an earlier period, and at a different discount rate to the underlying insurance contracts. Differences caused by these factors also are not accounting mismatches but reflect the different effect of the time value of money on the contractual service margin and fulfilment cash flows.

BC184 Furthermore, in the Board's view, including all expected future cash flows in the measurement of the contractual service margin at initial recognition of the reinsurance contract held reflects the conditions under which the entity agreed, under specified terms, to receive services from the reinsurer for future insurance contracts it expects to issue. If a reinsurance contract held provides an entity with neither substantive rights nor substantive obligations relating to future insurance contracts it expects to issue, then those future insurance contracts will be outside the boundary of the reinsurance contract held. The requirements for expected future cash flows in paragraphs 33–35 of IFRS 17 are a core aspect of the Standard. The Board sees no reason why these

 © IFRS Foundation

requirements should not be applied consistently—both to insurance contracts issued and reinsurance contracts held.

BC185 The Board noted there would be costs for some entities because such consistency represents a change from existing practice. However, the Board concluded that the benefits of appropriately reflecting an entity's rights and obligations as the holder of a reinsurance contract outweigh those costs. Accordingly, the Board disagreed with the suggestion by stakeholders to amend the contract boundary requirements in IFRS 17 for reinsurance contracts held.

Subjectivity in the determination of discount rates and the risk adjustment for non-financial risk (paragraphs 36–37 of IFRS 17)

BC186 The requirements in paragraphs 36–37 of IFRS 17 provide objectives that an entity is required to achieve when determining discount rates and the risk adjustment for non-financial risk. Those requirements do not prescribe how an entity achieves that outcome. Some stakeholders, in particular users of financial statements, expressed concerns that the principle-based nature of those requirements could limit comparability among entities and they would rather IFRS 17 constrained variability in practice.

BC187 Insurance contracts have a variety of forms, terms and conditions. In the Board's view, requiring an entity to measure discount rates and the risk adjustment for non-financial risk for insurance contracts using a rule-based approach would result in outcomes that are appropriate only in some circumstances. The approach in IFRS 17 for determining discount rates and the risk adjustment for non-financial risk requires entities to apply judgement when determining the inputs most relevant to the circumstances and requires entities to disclose information in the notes to the financial statements about the methods used and judgements applied. Entities applying IFRS 17 are all required to meet the same measurement objectives. The requirements in paragraphs 36–37 of IFRS 17 aim to achieve comparability without imposing arbitrary uniformity.

BC188 Discount rates and the risk adjustment for non-financial risk are core components of the measurement model. Any change to make the requirements more prescriptive with implementation already under way would likely significantly disrupt implementation and could diminish the usefulness of information provided by IFRS 17.

Risk adjustment for non-financial risk in a consolidated group of entities (paragraphs 37 and B86–B92 of IFRS 17)

BC189 Applying paragraph 37 of IFRS 17, an entity adjusts the estimate of the present value of the future cash flows to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk. The risk adjustment for non-financial risk reflects the degree of diversification benefit the entity includes when determining the compensation it requires for bearing that risk.

© IFRS Foundation

BC190 The Transition Resource Group for IFRS 17 discussed determining the risk adjustment for non-financial risk in an entity reporting as a consolidated group of entities. Transition Resource Group members held different views, as follows:

(a) some thought the risk adjustment for non-financial risk for a group of insurance contracts must be the same in the issuing entity's financial statements and in the consolidated financial statements of the group of entities. The risk adjustment for non-financial risk in both sets of financial statements reflects the compensation the issuing entity would require for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.

(b) others thought the risk adjustment for non-financial risk may be measured differently in the issuing entity's financial statements and in the consolidated financial statements of the group of entities. In their view, in the consolidated financial statements, the risk adjustment for non-financial risk reflects the compensation the reporting entity would require for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk. Those stakeholders noted that the reporting entity changes at different levels of consolidation and, therefore, that the compensation required by the reporting entity may also change. Those stakeholders also noted that entities that are subsidiaries of the same parent may use different approaches to determine the risk adjustment for non-financial risk.

BC191 Some stakeholders expressed concerns that the differing views described in paragraph BC190 will result in diversity in practice. Those stakeholders suggested that the Board amend IFRS 17 to clarify its intention for determining the risk adjustment for non-financial risk in the consolidated financial statements of a group of entities.

BC192 However, the Board concluded that clarifying this aspect of determining the risk adjustment for non-financial risk would not address all possible differences that could arise, given the judgement required in determining the risk adjustment for non-financial risk. In the Board's view, practice needs to develop in this area and, if necessary, the Board will seek to understand how the requirements are being applied as part of the Post-implementation Review of IFRS 17.

Discount rate used to determine adjustments to the contractual service margin (paragraphs 44 and B72 of IFRS 17)

BC193 Paragraph 44(c) of IFRS 17 requires an entity to adjust the contractual service margin for changes in fulfilment cash flows relating to future service. Consistent with feedback the Board considered when developing IFRS 17, some stakeholders expressed concerns about the difference that arises for groups of insurance contracts without direct participation features because:

(a) applying paragraph B72(a) of IFRS 17, fulfilment cash flows are measured at a current discount rate; whereas

 © IFRS Foundation

(b) applying paragraph B72(b) of IFRS 17, the resulting adjustment to the contractual service margin is measured at the discount rate determined at the date of initial recognition of the group of contracts (the 'locked-in rate').

BC194 Stakeholders suggested two alternative amendments to IFRS 17 relating to the discount rate used to determine adjustments to the contractual service margin for insurance contracts without direct participation features. Some stakeholders suggested those amendments would reduce the operational burden of applying the Standard, while others said it would be conceptually appropriate to measure the contractual service margin using the same current discount rate used for the measurement of fulfilment cash flows. The two suggested amendments were that an entity be required to:

(a) determine adjustments to the contractual service margin for changes in fulfilment cash flows relating to future service using a current discount rate; or

(b) remeasure the contractual service margin as a whole using a current discount rate.

BC195 The Board noted that the fulfilment cash flows and the contractual service margin are two different components of the measurement of insurance contracts. The fulfilment cash flows are a current risk-adjusted estimate of future cash flows expected to arise from a group of insurance contracts. In contrast, the contractual service margin is the profit expected to arise from future service that an entity will provide for a group of insurance contracts. The contractual service margin on initial recognition of a group is determined as the difference between the estimated cash inflows and estimated cash outflows (adjusted for the effect of the time value of money, non-financial risk and financial risk). It is not itself a future cash flow. When changes in fulfilment cash flows relate to future service, the expected profit relating to that future service changes. Accordingly, those changes in estimates adjust the contractual service margin.

BC196 The Board disagreed with the suggestion set out in paragraph BC194(a) for the same reasons it concluded, while developing IFRS 17, that an entity should determine adjustments to the contractual service margin using locked-in discount rates. Adjusting the contractual service margin for changes in fulfilment cash flows that relate to future service is necessary to ensure consistency between the treatment of expected future cash flows included in the measurement of a group of insurance contracts at initial recognition and the treatment of expected future cash flows included in the measurement of a group of insurance contracts subsequently. In the Board's view, measuring the effect of future cash flows on the contractual service margin at different discount rates depending on when they become part of the expected cash flows would create an inconsistency in the measurement of profit. Furthermore, the suggestion in paragraph BC194(a) would result in arbitrary amounts relating to the effects of changes in discount rates being reflected in the insurance service result rather than in insurance finance income or expenses. In the Board's view, the presentation of insurance finance income or

expenses separately from the insurance service result is a core benefit introduced by IFRS 17.

BC197 The Board also disagreed with the suggestion in paragraph BC194(b) for the same reasons it concluded, while developing IFRS 17, that an entity should remeasure the contractual service margin as a whole using a current discount rate for insurance contracts without direct participation features. In the Board's view, measuring the contractual service margin at the discount rate determined at the date of initial recognition provides a faithful representation of the revenue earned as the entity provides services, reflecting the price set at the contract issue date for that service. If the contractual service margin were to be fully remeasured to reflect current discount rates, the revenue recognised would reflect the effect of current interest rates on the price the entity would charge for the service if it were determining that price at the reporting date.

BC198 The Board disagreed with some stakeholders' view that a gain or loss arising from the difference between a change in fulfilment cash flows and a change in the adjustment to the contractual service margin would be difficult to explain. In the Board's view, that gain or loss provides information about the cumulative amount of insurance finance income or expenses that had been previously recognised and should be reversed, or the amount that was not previously recognised and now is.

BC199 When the Board developed the requirements for the contractual service margin, it was aware that developing systems for determining the contractual service margin would be a significant cost for some entities regardless of whether the contractual service margin was measured at a locked-in rate or a current rate. However, in the Board's view, the measurement and recognition of the contractual service margin is a fundamental benefit introduced by IFRS 17.

Other comprehensive income option for insurance finance income or expenses (paragraphs 88–89 and B129–B133 of IFRS 17)

BC200 Paragraphs 88–89 of IFRS 17 provide an entity with an accounting policy choice between including insurance finance income or expenses for the period in profit or loss or disaggregating insurance finance income or expenses between profit or loss and other comprehensive income (referred to as the 'other comprehensive income option'). Some stakeholders, in particular users of financial statements, expressed concerns that providing an option, rather than setting a requirement or a prohibition to present the effect of some changes in financial assumptions in other comprehensive income, could reduce comparability among entities and increase complexity. Those stakeholders would rather IFRS 17 required one consistent presentation.

BC201 The Board acknowledged that requiring entities to report insurance finance income or expenses entirely in profit or loss rather than permitting the choice in paragraphs 88–89 of IFRS 17 would improve comparability among entities. However, the Board concluded that the presentation of insurance finance

 © IFRS Foundation

income or expenses as a systematic allocation in profit or loss may provide more useful information than total insurance finance income or expenses in profit or loss for some contracts and less useful information for other contracts.

BC202 As noted in paragraph BC44 of the Basis for Conclusions on IFRS 17, the Board concluded that entities within the same jurisdiction are likely to make similar accounting policy choices because they are likely to issue similar contracts and adopt similar asset strategies for those contracts. Hence, they are likely to remain comparable.

Business combinations (paragraphs 39, B5 and B93–B95 of IFRS 17)

BC203 Some stakeholders expressed concerns that it will be operationally burdensome to apply the requirement in paragraph 15 of IFRS 3 (see paragraph BC162). They also observed that applying that requirement will result in differences in accounting between an acquirer's consolidated financial statements and an acquiree's financial statements. Those stakeholders suggested the Board amend IFRS 3 to reinstate the previous exception in paragraph 17(b) of IFRS 3 for insurance contracts and to make that exception optional rather than mandatory.

BC204 Some stakeholders also expressed concerns—consistent with feedback the Board considered when developing IFRS 17—that applying paragraph B5 of IFRS 17 to contracts acquired in their settlement period is a significant change from existing practice. Applying paragraph B5 of IFRS 17 to contracts acquired in their settlement period (that is, after the event insured by the acquiree has occurred), the insured event for the acquirer is the determination of the ultimate cost of those claims. An acquirer will recognise a liability for remaining coverage for those contracts, whereas the acquiree will recognise a liability for incurred claims.

BC205 Some stakeholders noted particular costs relating to the requirements for business combinations for entities that would apply the premium allocation approach to all insurance contracts they issue. For such entities, the need to develop systems for the contractual service margin may only arise because of insurance contracts acquired during their settlement period. Furthermore, some stakeholders expressed the view that the information provided may be misleading or counterintuitive because similar contracts will be accounted for differently based on whether they have been issued by an entity or acquired by an entity during the settlement period of the contract. Some stakeholders explained that they thought the requirements would result in revenue and expenses for the same contracts being recognised twice—once by the acquiree and once by the acquirer. Some stakeholders suggested the Board amend IFRS 17 to exempt insurance contracts acquired in a business combination from the general requirements for the determination of the insured event.

BC206 The exception in paragraph 17(b) of IFRS 3 was introduced for IFRS 4 because, unlike IFRS 17, IFRS 4 did not provide requirements for measuring insurance contracts. Requiring a change in measurement as a result of a business combination would, therefore, be inconsistent with the requirements of IFRS 4. By removing the exception in IFRS 3, IFRS 17 makes the accounting for acquisitions of insurance contracts consistent with the account for acquisitions of other contracts acquired in a business combination. Differences in accounting between an acquirer's financial statements and an acquiree's financial statements are not unique to insurance contracts and are not unusual when applying IFRS Standards. Other Standards do not provide exceptions to the classification principles in IFRS 3. For example, a financial asset classified as measured at amortised cost by an acquiree will be assessed by an acquirer at the date of acquisition and may not be eligible for classification in that category in the acquirer's consolidated financial statements. The Board noted that one of the objectives of IFRS 17 was to bring insurance accounting in line with accounting for other types of contracts. Accordingly, the Board disagreed with the suggestion by stakeholders to reinstate the exception in IFRS 3 for acquired insurance contracts because it would result in a significant loss of useful information relative to that which would result from applying IFRS 3 as amended by IFRS 17—it would increase complexity for users of financial statements and reduce comparability with the requirements for other transactions and other industries.

BC207 Similarly, the Board also disagreed with a suggestion from stakeholders to exempt insurance contracts acquired in a business combination from the general requirements for determining the insured event. Doing so would create complexity for users of financial statements and reduce comparability with the requirements for other transactions. An acquirer in a business combination identifies assets and liabilities acquired based on the contractual terms and economic conditions that exist at the acquisition date. The Board noted that for a contract to meet the definition of an insurance contract from the perspective of the acquirer, there must be an uncertain future event for which the acquirer compensates the policyholder. Furthermore, paragraph 59 of IFRS 3 requires an entity to disclose information that enables users of financial statements to evaluate the nature and financial effect of a business combination.

BC208 The Exposure Draft does, however, clarify that an entity can continue to use the exception in paragraph 17(b) of IFRS 3 for business combinations that occurred before the date of initial application of IFRS 17 (see paragraph BC162) and proposes a transition relief for insurance contracts acquired in their settlement period before the date of transition to IFRS 17 (see paragraph BC121).

© IFRS Foundation

Scope of the variable fee approach (paragraph B101 of IFRS 17)

BC209 Insurance contracts with direct participation features (contracts in the scope of the variable fee approach) are substantially investment-related service contracts under which an entity promises an investment return based on underlying items and accepts significant insurance risk. Hence, paragraph B101 of IFRS 17 defines insurance contracts with direct participation features as insurance contracts for which:

(a) the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items;

(b) the entity expects to pay to the policyholder an amount equal to a substantial share of the fair value returns on the underlying items; and

(c) the entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items.

BC210 Some stakeholders have suggested the Board amend IFRS 17 to expand the scope of the variable fee approach to include:

(a) insurance contracts that some stakeholders view as economically similar to insurance contracts with direct participation features except that they do not meet the criterion in paragraph B101(a) of IFRS 17; and

(b) reinsurance contracts issued, which are explicitly excluded from the variable fee approach applying paragraph B109 of IFRS 17.

BC211 The scope of the variable fee approach identifies those contracts for which the Board thought modifications to the general model were necessary because the contracts provide substantially investment-related services in exchange for a fee that depends on the returns on underlying items. Those modifications were designed specifically to faithfully represent the profit on insurance contracts in the scope of the variable fee approach. Consequently, the Board concluded that if it were to consider amending the scope of the variable fee approach it would also need to consider amending those modifications. The Board also noted that whatever the scope of the variable fee approach, there would always be differences between the accounting for contracts within the scope and contracts outside the scope.

BC212 The additional insurance contracts that some stakeholders suggested should be in the scope of the variable fee approach do not meet the criterion in paragraph B101(a) of IFRS 17 because the relationship between the pool of underlying items and insurance contract liabilities does not arise from a contractual obligation. A fundamental aspect of the variable fee approach is that the entity's share of the underlying items is regarded as a variable fee. For this to be the case, in the Board's view, the contract must specify those underlying items. An entity cannot be regarded as providing substantially investment-related service to a policyholder if the pool of underlying items is not specified. Accordingly, the Board disagreed with those stakeholders'

suggestion that insurance contracts should be within the scope of the variable fee approach even if they fail to meet the criterion in paragraph B101(a) of IFRS 17.

BC213 Some stakeholders suggested that an entity that issues reinsurance contracts should be permitted to apply the variable fee approach to such contracts if they meet the criteria in paragraph B101 of IFRS 17. Some of those stakeholders suggested that if reinsurance contracts issued are assessed against the criteria, the underlying items would always be the underlying insurance contracts. Therefore, in the view of those stakeholders, reinsurance contracts issued would be within the scope of the variable fee approach if the reinsurance contract provides proportionate coverage for a substantial share of the underlying risks. Other stakeholders proposed that a narrow set of reinsurance contracts issued—for example, some internal reinsurance arrangements—could meet the criteria for the scope of the variable fee approach. The Board disagreed with these suggestions because, although it had already acknowledged that in some specific circumstances a reinsurance contract issued might meet the criteria in paragraph B101 of IFRS 17, the Board did not intend the variable fee approach to apply to reinsurance contracts. The Board designed the variable fee approach for contracts that are substantially investment-related service contracts. In contrast, reinsurance contracts provide insurance coverage and do not provide substantially investment-related services. The Board also observed that adding an option for entities to apply the variable fee approach to reinsurance contracts issued would be inconsistent with the approach in IFRS 17 that using the variable fee approach is mandatory for contracts within its scope.

Interim financial statements (paragraph B137 of IFRS 17)

BC214 IAS 34 *Interim Financial Reporting* states that the frequency of an entity's reporting should not affect the measurement of its annual results. As an exception to this, paragraph B137 of IFRS 17 requires that an entity does not 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 requires changes in estimates of the fulfilment cash flows to adjust the contractual service margin, whereas experience adjustments are recognised in profit or loss immediately—thus the accounting depends on the timing of a reporting date. The Board developed the exception to IAS 34 in paragraph B137 of IFRS 17 in response to stakeholder feedback that recalculating the carrying amount of the contractual service margin annually when the entity has prepared interim financial statements applying IAS 34 would be a significant practical burden because of the different treatments of changes in estimates and experience adjustments.

BC215 Some stakeholders suggested the Board amend IFRS 17 to expand paragraph B137 of IFRS 17 so it applies to accounting estimates made in all interim reports whether or not IAS 34 is applied, to avoid the need to keep two sets of accounting estimates. For example, a parent entity may require a subsidiary to provide internal interim reports because the parent entity

© IFRS Foundation

produces interim financial statements applying IAS 34. The internal interim reports are not interim financial statements applying IAS 34 from the perspective of the subsidiary, so the subsidiary would need to maintain accounting estimates for these reports separately from the accounting estimates needed for its financial statements prepared using IFRS Standards. Other stakeholders suggested the Board not expand paragraph B137 of IFRS 17, but permit rather than require its application.

BC216 The Board disagreed with the stakeholders' suggestions discussed in paragraph BC215 because those suggestions would add complexity for both preparers and users of financial statements and would reduce comparability among entities. This is because:

(a) different entities could develop different definitions of an interim report if they were permitted to use interim reports other than those addressed by IAS 34. The Board noted that entities may prepare interim reports other than those addressed by IAS 34, for example, an internal management report, for a variety of purposes.

(b) different entities would treat accounting estimates made in previous interim financial statements in different ways to each other if they were permitted rather than required to apply paragraph B137 of IFRS 17.

Mutual entities issuing insurance contracts (paragraphs BC264–BC269 of the Basis for Conclusions on IFRS 17)

BC217 The requirements in IFRS 17 apply to all insurance contracts as defined in IFRS 17, regardless of the type of entity issuing the contract, with some specific scope exclusions. Paragraph BC265 of the Basis for Conclusions on IFRS 17 explains that a defining feature of a mutual entity that issues insurance contracts is that the most residual interest of the entity is due to a policyholder and not a shareholder. Paragraphs BC264–BC269 of the Basis for Conclusions on IFRS 17 explain the consequences of IFRS 17 for such mutual entities, and why the Board did not include any specific requirements or exceptions to requirements in IFRS 17 for such entities.

BC218 Stakeholders expressed two concerns about mutual entities applying the requirements in IFRS 17, as follows:

(a) some did not think the requirements in IFRS 17 provide useful information about entities with the feature that the most residual interest of the entity is due to a policyholder and not a shareholder. IFRS 17 requires an entity to include in the fulfilment cash flows all the expected future cash flows to current and future policyholders, including discretionary cash flows. Thus, the fulfilment cash flows of insurance contracts issued include any rights of policyholders to the residual interest of the entity. These requirements result in a mutual entity as described in paragraph BC265 of the Basis for Conclusions on IFRS 17 having, in principle, no equity and no total comprehensive income in any accounting period. Some stakeholders think this is a

misleading depiction of the financial position and financial performance of such an entity.

(b) some expressed concern about the description of mutual entities as entities that issue insurance contracts under which the most residual interest of the entity is due to a policyholder and not a shareholder. Those stakeholders noted that in practice the term 'mutual entities' is used to describe some entities that do not issue such insurance contracts. Those stakeholders expressed concern that the paragraphs in the Basis for Conclusions on IFRS 17 that discuss 'mutual entities' might lead some to expect entities that are described as 'mutual entities' but do not issue such insurance contracts also to have, in principle, no equity and no total comprehensive income in any accounting period.

BC219 The Board reaffirmed its decision that IFRS 17 should not include any specific requirements or exceptions to requirements in IFRS 17 for entities that issue insurance contracts under which the most residual interest of the entity is due to a policyholder and not a shareholder because:

(a) the requirements in IFRS 17 to include in the fulfilment cash flows all the expected future cash flows that arise within the boundary of insurance contracts in a group of contracts, including discretionary cash flows and those due to future policyholders, are a core principle of the Standard applicable to all entities;

(b) if different entities account for the same insurance contract in different ways, comparability across entities would be reduced; and

(c) a robust definition of entities to which different requirements would apply would be difficult to create.

BC220 In response to the stakeholders' concerns described in paragraph BC218(b), the Board decided to add a footnote to paragraph BC265 of the Basis for Conclusions on IFRS 17 to explain that not all entities that may be described as mutual entities have the feature that the most residual interest of the entity is due to a policyholder.

Effects Analysis

BC221 The following table analyses the likely effects, including the costs and benefits, of the proposed amendments compared to the likely effects of IFRS 17.

© IFRS Foundation

Topic	Effects on financial statements	Cost-benefit analysis
Scope exclusion for some credit card contracts that meet the definition of an insurance contract	Entities issuing credit card contracts that meet the definition of an insurance contract that would be excluded from the scope of IFRS 17 would apply IFRS 9 to such contracts. The Board expects that often the outcome of applying IFRS 9 to such contracts would be similar to how those entities applied IFRS 4. Hence, no significant effect on financial statements is expected.	Accounting for such contracts in the same way as credit card contracts that do not meet the definition of an insurance contract is expected to provide comparable information for the users of financial statements for the entities that issue credit card contracts. The proposed amendment is expected to reduce IFRS 17 implementation costs for entities that do not typically issue other contracts within the scope of IFRS 17. Those entities would not need to implement IFRS 17 because they would apply IFRS 9 to account for such credit cards.
Scope exclusion for some loan contracts that meet the definition of an insurance contract	No change for the entities that would elect to apply IFRS 17 to such loan contracts. Entities that would elect to apply IFRS 9 to such loan contracts are expected to use accounting for those contracts that is consistent with accounting for similar financial instruments they issue. For example, measuring them at fair value through profit or loss.	The proposed amendment is expected to enable an entity to apply either: (a) IFRS 17 to such loan contracts, permitting comparability with the other insurance contracts issued by the same entity; or (b) IFRS 9 to such loan contracts, permitting comparability with financial instruments issued by the same entity. The proposed amendment is expected to reduce IFRS 17 implementation costs for entities that do not typically issue other contracts within the scope of IFRS 17. Those entities would not need to implement IFRS 17 because they could apply IFRS 9 to such loan contracts. Measuring those loan contracts applying IFRS 9 or IFRS 17 is expected to provide useful information to users of financial statements in either case, without unduly reducing comparability or unduly increasing the costs of analysis for users of financial statements.

continued...

...continued

Topic	Effects on financial statements	Cost-benefit analysis
Expected recovery of insurance acquisition cash flows	The proposal to allocate insurance acquisition cash flows to expected contract renewals and recognise them as an asset, rather than as part of the measurement of the initial contracts, is expected to: (a) reduce the number of insurance contracts determined to be onerous at initial recognition; and (b) increase the amount and duration of the asset recognised for those cash flows.	Users of financial statements are expected to benefit from obtaining additional information about expected contract renewals and related disclosures—that is, the reconciliation of the asset at the beginning and end of the reporting period showing changes for any impairment loss or reversals and the quantitative disclosure of the expected timing of the inclusion of these acquisition cash flows in the measurement of the related group of insurance contracts. The requirement to assess the recoverability of the asset is expected to increase the ongoing costs of IFRS 17 for entities. However, that assessment would only be required if facts and circumstances indicate the asset may be impaired. On balance, the potential additional costs are expected to be justified given stakeholder feedback that the proposed amendment is expected to make it easier for entities to explain the results of applying IFRS 17 to users of financial statements.

continued...

 © IFRS Foundation

...continued

Topic	Effects on financial statements	Cost-benefit analysis
Contractual service margin attributable to investment-return service	The proposed amendment is expected to change the pattern of recognition of profit to better align it with the provision of different services when the entity provides investment-return service.	The proposed disclosures about the contractual service margin are expected to mitigate the costs of analysis for users of financial statements that might be created by any increase in subjectivity and reduction in comparability between entities. The proposed amendment is expected to provide relevant information about the investment-return service provided under a contract. However, the proposed amendment might disrupt implementation processes already under way and, therefore, increase costs, particularly for entities that are at an advanced stage of IFRS 17 implementation. On balance, the potential disruption is expected to be justified given stakeholder feedback about the increased usefulness of information.

continued...

...continued

Topic	Effects on financial statements	Cost-benefit analysis
Reinsurance contracts held—recovery of losses on underlying insurance contracts	The proposed amendment changes the accounting for reinsurance contracts held that provide proportionate coverage when they relate to underlying contracts that are onerous at initial recognition. It does not affect the accounting for the underlying insurance contracts issued. Applying the proposed amendment an entity would recognise in profit or loss the recovery of a loss immediately and the adjusted net cost or net gain of purchasing reinsurance as reinsurance services are received.	The proposed amendment: (a) is expected to improve consistency between the accounting treatment for reinsurance contracts held relating to the initial recognition of underlying onerous contracts and subsequent adverse changes in onerous groups of underlying contracts; (b) is expected to reduce the complexity for users of financial statements in understanding the accounting for reinsurance contracts held, by reducing accounting mismatches; (c) might disrupt implementation processes for entities that have already started those processes and might, therefore, increase costs for those entities; and (d) is not expected to unduly increase the ongoing costs of IFRS 17 for entities or costs of analysis for users of financial statements because it expands an exception to the general requirements for reinsurance contracts held in IFRS 17.

continued...

© IFRS Foundation

...continued

Topic	Effects on financial statements	Cost-benefit analysis
Presentation in the statement of financial position	The proposed amendment—which would require entities to separately present insurance contracts at portfolio level rather than at group level—is expected to reduce the amount of insurance contract assets presented in the statement of financial position. This is because it is expected that many groups of insurance contracts will typically move between asset and liability positions, whereas most portfolios of insurance contracts are expected to remain in a liability position.	Although offsetting groups in the statement of financial position would result in a loss of useful information for users of financial statements, the Board regards the loss of information as acceptable when balanced against the significant cost relief for entities. Initial investor outreach indicates that the loss of useful information caused by this proposed amendment would be acceptable. The impact on the costs of analysis for users of financial statements is not expected to be significant.
Applicability of the risk mitigation option	Entities with reinsurance contracts held that use the risk mitigation option to recognise changes in underlying insurance contracts with direct participation features caused by changes in financial assumptions in profit or loss, rather than as adjustments to the contractual service margin will reduce accounting mismatches with the related changes in the reinsurance contracts held.	The proposed risk mitigation option for reinsurance contracts held: (a) is expected to reduce accounting mismatches and, therefore, reduce complexity for preparers and users of financial statements in understanding the accounting for insurance contracts; and (b) is not expected to unduly increase implementation costs for entities because it is optional.
Effective date of IFRS 17	The proposed deferral of the effective date of IFRS 17 by one year would further delay the improvements introduced by IFRS 17.	The proposed amendment would allow more time for entities and users of financial statements to implement IFRS 17. The proposed amendment is expected to increase implementation costs for entities that are furthest advanced in the implementation of IFRS 17. Limiting the deferral of the effective date of IFRS 17 to one year is expected to minimise such disruption.

continued...

...continued

Topic	Effects on financial statements	Cost-benefit analysis
IFRS 9—temporary exemption	The proposed extension of the temporary exemption from applying IFRS 9 by one year is expected to: (a) further delay the improvements introduced by IFRS 9 for some entities, particularly those relating to information about expected credit losses; and (b) prolong inconsistency between insurance entities and other entities applying IFRS Standards.	In the light of the proposed one-year deferral of the effective date of IFRS 17, the proposed amendment is expected to reduce accounting mismatches and volatility by allowing entities to apply IFRS 17 and IFRS 9 on the same date. Entities would first apply IFRS 9 up to eight years after it was issued and up to four years after other entities first applied IFRS 9, resulting in costs of analysis for users of financial statements. To mitigate those costs, entities that continue to apply IAS 39 would continue to provide the additional disclosures required by IFRS 4 to enable users of financial statements to make comparisons with entities applying IFRS 9 for one additional year.

continued...

 © IFRS Foundation

...continued

Topic	Effects on financial statements	Cost-benefit analysis
Transition relief for the classification of contracts acquired in their settle-ment period	The proposed amendment is expected to reduce revenue and expenses recognised by entities. This is because the proposed amendment would permit an entity to account for some liabili-ties for claims settlement acquired in a business combina-tion as a liability for incurred claims, rather than as a liability for remaining coverage. Liabili-ties for incurred claims do not give rise to revenue and expenses for expected claims. The proposed amendment would: (a) allow more entities to use the modified retrospec-tive approach, instead of the fair value approach; and (b) provide additional relief within the fair value approach.	The proposed amendment treats liabilities acquired in a manner that is inconsistent with the principles of business combination accounting by not reflecting the terms and conditions that exist at the acquisi-tion date. This adds complexity for users of financial statements. Permitting an entity to account for liabilities for claims settlement acquired in a business combination as a liability for incurred claims on transition to IFRS 17 is expected to ease implementation for entities that have acquired contracts before the date of transition to IFRS 17.
Transition relief for the date of application of the risk mitigation option	Applying the proposed amendment, entities that opt to use the risk mitigation option from the date of transition to IFRS 17—that is, the beginning of the annual report-ing period immediately before the date of initial application—would reflect the effects of risk mitigation on comparative information when first applying IFRS 17.	A prospective application of the risk mitigation option from the date of transition to IFRS 17 is expected to reduce accounting mismatches in the comparative period presented and to achieve comparability over time. Application of the risk mitigation option is optional. Therefore, the proposed amendment is not expected to unduly increase implementation costs for entities. The disclosures required by IFRS 17 at transition are expected to mitigate the costs of analysis for users of financial statements introduced by the additional optionality.

continued...

...continued

Topic	Effects on financial statements	Cost-benefit analysis
Transition relief for the application of the risk mitigation option and the use of the fair value transition approach	At the date of transition to IFRS 17, the equity of an entity that applies the proposed amendment is expected to reflect previous changes in the fulfilment cash flows due to changes in financial assumptions and changes in the fair value of the derivatives if the entity has used derivatives or reinsurance to mitigate financial risk before the date of transition.	The information provided applying the fair value transition approach is expected to be useful to users of financial statements because it reduces accounting mismatches. The proposed amendment introduces an option, rather than a requirement, for entities to apply the fair value transition approach to a group of insurance contracts with direct participation features. Therefore, the proposed amendment is not expected to unduly increase implementation costs for entities. The disclosures required by IFRS 17 at transition are expected to mitigate the costs of analysis for users of financial statements introduced by the additional optionality.
Minor amendments	Proposed minor amendments either clarify the wording in IFRS 17 or correct relatively minor unintended consequences, oversights or conflicts between the requirements of IFRS 17 and other Standards. Accordingly, they are not expected to have significant effects.	

© IFRS Foundation

IAS®

International Financial Reporting Standards®

IFRIC®

IFRS Foundation®

SIC®

IFRS®

IASB®

Contact the IFRS Foundation for details of countries where its trade marks are in use or have been registered.

The International Accounting Standards Board is the independent standard-setting body of the IFRS Foundation

Columbus Building | 7 Westferry Circus | Canary Wharf
London E14 4HD | United Kingdom
Telephone: +44 (0)20 7246 6410
Email: info@ifrs.org | Web: www.ifrs.org

Publications Department
Telephone: +44 (0)20 7332 2730
Email: publications@ifrs.org

IAS®

SET ISBN 978-1-911629-32-0

PART B ISBN 978-1-911629-34-4