BACKGROUND BRIEFING PAPER

IFRS 17 *INSURANCE CONTRACTS* AND TRANSITION

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EFRAG

European Financial Reporting Advisory Group

This paper provides an overview of the main provisions in IFRS 17 that relate to transition. It uses highly simplified examples to illustrate the application of certain aspects of IFRS 17. These examples do not necessarily illustrate the only way that IFRS 17 could be applied to the fact pattern described. It is necessary to read IFRS 17 for a full understanding of the relevant requirements.

Contents

Introduction

1 This background briefing paper deals with the transition to IFRS 17 *Insurance Contracts*. The effective date of IFRS 17 is 1 January 2021 with earlier application permitted. The transition requirements are an important aspect of IFRS 17 and have been the subject of extensive debate both during the development of the Standard and since its publication.

2 This is the third of three background briefing papers on IFRS 17. The aim of these documents is to provide simplified information on controversial areas of IFRS 17 to enable constituents to understand the issues and be in a position to comment on EFRAG's draft endorsement advice.

3 The first paper in this series, *Level of Aggregation*, deals with the definition of a "group of insurance contracts" including the annual cohort requirement. The second, *Release of the Contractual Service Margin*, deals with that aspect of performance.

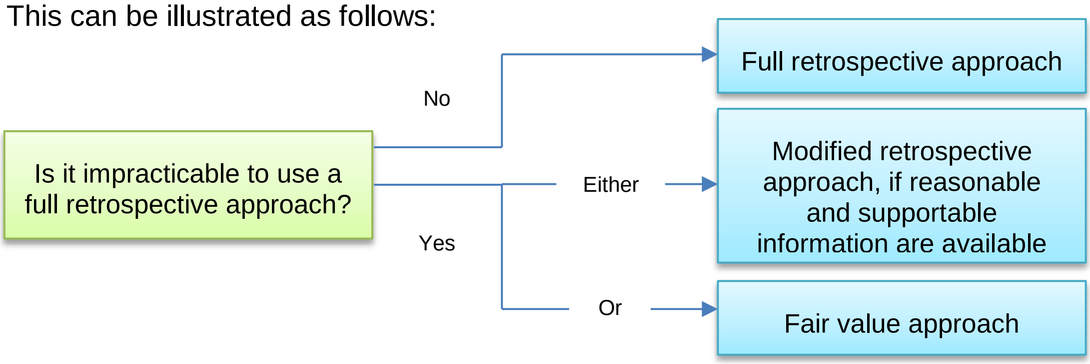
4 This background document discusses the transition requirements of IFRS 17. In summary, the default transition approach is retrospective application but IFRS 17 provides for two alternative approaches in cases where it is impracticable[1] to apply a fully retrospective approach.

5 Whilst IFRS 17 applies to all entities that write insurance contracts and not only insurance companies, it is expected that the biggest impact is on the latter and so this paper refers to insurance companies or insurers throughout.

Why is this important?

6 IFRS 17 is applied retrospectively unless impracticable, subject to two minor exceptions discussed in paragraph 12 below (IFRS 17, paragraph C3). This means that insurers recognise and measure insurance contracts as if IFRS 17 had always been applied. In IFRS 17 paragraph BC372, the IASB notes that full retrospective application provides the most useful information by allowing comparisons between contracts written before and after the date of initial application of the Standard. However, full retrospective application could be difficult, requiring significant time, effort, resources and a large amount of high-quality historical data. Therefore, transition relief was provided. If an insurer can demonstrate that full retrospective application is impracticable for a group of insurance contracts, that insurer may choose between applying either the modified retrospective approach or the fair value approach for that group of insurance contracts (IFRS 17, paragraph C5).

7 This can be illustrated as follows:



8 The impact of the different transition approaches applied could last for a number of years given the long-term nature of some of the business written by insurers. This could reduce comparability between the financial statements of insurers. In addition,

[1] Under IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* paragraph 5, a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

because the IFRS 17 impracticability assessment is made at the level of a group of insurance contracts, different transition approaches can be applied:

(a) for different groups of insurance contracts within the same reporting entity; and

(b) by different entities within the same reporting entity.

9 The transition approach applied could affect future profitability as the contractual service margin ('CSM')[2] determined on transition is only recognised in profit or loss as and when services are rendered. The IASB acknowledged this and therefore IFRS 17 requires separate disclosure of the transition amounts to enable users of financial statements to identify the effect of groups of insurance contracts measured at the transition date applying the modified retrospective approach and the fair value approach on the CSM and insurance revenue in subsequent periods (IFRS 17, paragraphs 114-116).

10 It will be important for insurers to explain how they determined the measurement of insurance contracts that existed at the transition date and for users to understand the nature and significance of the methods used and judgments applied arising from the choices made at transition date. Therefore, this paper aims to explore the different transition requirements.

Issues raised with the transition requirements in IFRS 17[3]

11 In EFRAG's deliberations so far, some concerns have been raised about certain aspects of IFRS 17's transition requirements. The following aspects (in no specific order) are considered further in this paper:

(a) It is not permitted to apply IFRS 17's optional risk mitigation solution for contracts with direct participation retrospectively on transition. The risk mitigation solution is intended to enable entities to reduce accounting mismatches when they use derivatives to manage financial risks. Some insurers have expressed the concern that prospective application will lead to accounting mismatches in future reporting periods. See paragraphs 13-14 for more information on the transition requirements for the optional risk mitigation solution for contracts with direct participation features.

(b) The modified retrospective approach requires the insurer to adjust the future cash flows estimated at the date of transition (or an earlier date) for cash flows that are known to have occurred between the date of initial recognition and the date of transition (or the same earlier date). A concern has been raised that, in some cases, the data available on these past cash flows may not be sufficient to ensure an estimate of the CSM at transition that reflects the insurer's view on profitability of these cash flows. In addition, some insurers would like to apply the modified retrospective approach to a larger number of insurance liabilities than permitted by IFRS 17. See paragraphs 26-32 for more information on determining the CSM at transition under the modified retrospective approach.

(c) The CSM at transition under the fair value approach could differ from the amount that would be determined under retrospective application and might be lower. As the release of the CSM affects revenue, a lower CSM may result in a lower insurance revenue amount after transition. The CSM at transition under the fair value approach would be affected by various factors, including market conditions at the date of transition, the reference market and the unit

[2] The CSM represents the unearned profit under the group of contracts that relates to future service to be provided under the contracts. (IFRS 17, paragraph 38).

[3] EFRAG has not quantified those effects or tried to estimate their impact.

of account applied in accordance with IFRS 13 *Fair Value Measurement*. The CSM determined based on the (modified) retrospective approach reflects the future profits expected from existing business written and is entity-specific. See paragraphs 36-37 for more information on determining the CSM at transition under the fair value approach.

(d) Restatement of comparative information is required by IFRS 17 under all transition methods (IFRS 17, paragraph C2). However, restatement of comparative information is not required when IFRS 9 *Financial Instruments* is first applied (which is expected to be in 2021 for most insurers, i.e. at the same time as IFRS 17) (IFRS 9, paragraph 7.2.15). This is seen by some as a reduction of the implementation period by one year. SEC registrants should provide two years of comparative figures or can omit any reconciliation when compliant with IFRS Standards as issued by the IASB. See paragraphs 48-49 for more information on IFRS 17's requirements for comparative information.

Transition approaches explained

Retrospective application

12 In applying IFRS 17 retrospectively at the date of transition, insurers are required to recognise and measure each group of insurance contracts as if IFRS 17 had always been applied with the following exceptions:

(a) the optional risk mitigation solution for contracts with direct participation features (in IFRS 17, paragraph B115) may not be applied before the date of initial application of IFRS 17 – see below; and

(b) an entity is not required to present quantitative information as required by IAS 8, paragraph 28(f).

Optional risk mitigation solution

13 Insurers applying the Variable Fee Approach ('VFA')[4] for contracts with direct participation features that use derivatives to manage financial risks are permitted, but not required, to apply IFRS 17's 'risk mitigation solution'. Using this solution the effects of changes in fulfilment cash flows and the insurer's share in the fair value returns on underlying items that would otherwise adjust the CSM under the VFA approach are instead recognised in profit or loss (IFRS 17, paragraph B115). One of the conditions for applying this option is to document the risk management objective and the strategy for mitigating the risk. This is similar to IFRS 9's documentation requirement to be eligible for hedge accounting (note that hedge accounting under IFRS 9 is also subject to other eligibility criteria that do not apply to IFRS 17's risk mitigation solution). As noted above, the risk mitigation solution may not be applied before the date of initial application of IFRS 17. The IASB explains that this prohibition on retrospective application is consistent with IFRS 9 and is considered necessary to avoid the use of hindsight. The IASB was concerned that documentation after the event could enable insurers to choose the risk mitigation relationships to which it would apply this option, particularly because the application of this approach is optional (IFRS 17, paragraph BC393).

14 If the risk mitigation solution was applied retrospectively, the insurer might determine a different amount of CSM and equity at transition. As noted above, EFRAG has been made aware of a concern that prospective application will lead to accounting mismatches in future reporting periods. This is because previous gains or losses on

[4] The Variable Fee Approach is a variation on the General Model. When applying the Variable Fee Approach, the insurer's share of the fair value changes of the underlying items is included in the contractual service margin. As a consequence, the fair value changes are not recognised in profit or loss in the period in which they occur but over the remaining life of the contract.

derivatives used to manage financial risks will be part of equity at the date of initial application of IFRS 17, but the effects of the financial risks that those derivatives are used to manage will not be eliminated from the CSM at transition and hence will affect profit or loss in future periods.

Difficulties with the retrospective approach

15 The IASB noted (IFRS 17, paragraph BC375) that the IFRS 17 measurement model comprises two components:

(a) a direct measurement, which is based on estimates of the present value of future cash flows (both in- and out-flows such as premiums and claims) and an explicit risk adjustment for non-financial risk; and

(b) a CSM, which is measured on initial recognition of the group of insurance contracts, then adjusted for subsequent changes in estimates relating to future service and a financing component and recognised in profit or loss over the coverage period.

16 The IASB also noted that measuring the remaining amount of the CSM at the transition date, and the information needed for presentation in the statement(s) of financial performance in subsequent periods, is more challenging (IFRS 17, paragraphs BC377-BC378). These amounts reflect a revision of estimates for all periods after the initial recognition of the group of insurance contracts. As a result, they have concluded that measuring the following amounts needed for retrospective application would often be impracticable:

(a) the estimates of cash flows at the date of initial recognition;

(b) the risk adjustment for non-financial risk at the date of initial recognition;

(c) the changes in estimates that would have been recognised in profit or loss for each accounting period because they did not relate to future service, and the extent to which changes in the fulfilment cash flows would have been allocated to the loss component;

(d) the discount rates at the date of initial recognition; and

(e) the effect of changes in discount rates on estimates of future cash flows for contracts for which changes in financial assumptions have a substantial effect on the amounts paid to policyholders.

17 Other operational challenges also include but are not limited to the following:

(a) quantification of the amounts charged to policyholders;

(b) amounts paid that would not have varied based on the underlying items;

(c) subsequent measurement of CSM at the right level of aggregation;

(d) tracking of the experience adjustments on investment components;

(e) estimation of discount rates subsequent to initial recognition;

(f) determination of the risk adjustment;

(g) measurement of the changes in future cash flows; and

(h) changes in the fair value of the underlying items for insurance contracts with direct participation features.

18 Consequently, the IASB developed two alternative transition methods (modified retrospective approach and the fair value approach) for use when retrospective application of IFRS 17 would be impracticable.

19 EFRAG notes that, although the two alternative transition methods provide various reliefs from retrospective application, certain aspects of IFRS 17 must be applied

retrospectively under all methods. In particular, IFRS 17 does not provide relief from retrospective application in relation to its scope or to its requirements on separating components of an insurance contract ('unbundling'). The scope of IFRS 17 is similar to the scope of IFRS 4, but the requirements on unbundling are somewhat different. Insurers will also have to assess the unbundling of certain components of insurance contracts under IFRS 17 retrospectively for all contracts. This may lead to the recognition or derecognition of different components of insurance contracts compared to IFRS 4.

20 In addition, on transition to IFRS 17, insurers will have to deal with the existing acquisition cash flows balance.

(a) *Past groups of insurance contracts* (e.g. contracts that have lapsed before transition) *and acquisition cash flows that do not meet the definition under IFRS 17*: These, if any, are recognised as part of retained earnings (i.e. eliminated);

(b) *Existing groups of insurance contracts*: acquisition cash flows that relate only to existing contracts are included in the cash flows in order to compute the insurance liability. As a result, at transition date, the contractual service margin of the group of insurance contracts at inception takes into account acquisition cash flows for existing contracts;

(c) *Future groups of insurance contracts*: Insurance acquisition cash flows that relate to future contracts to be written would be recognised as an asset or liability and then allocated to the relevant group of fulfilment cash flows once new contracts are written.

Modified retrospective approach

21 The modified retrospective approach aims to mitigate the operational challenges identified in paragraphs 16-17 above while achieving an outcome as close as possible to full retrospective implementation, using reasonable and supportable information available without undue cost or effort. Therefore, it allows simplifications with regard to:

(a) the assessments at inception or initial recognition (IFRS 17, paragraphs C9-C10);

(b) to the determination of the CSM (IFRS 17, paragraphs C11-17); and

(c) insurance finance income or expense (IFRS 17, paragraphs C18-C19).

22 Under this approach insurers use the permitted modifications as described above only to the extent that they do not have reasonable and supportable information to apply the full retrospective approach. Consistent with retrospective application, insurers need to eliminate items such as deferred acquisition costs and some intangible assets that relate solely to existing contracts (IFRS 17, paragraph BC374).

Assessments at inception or initial recognition

23 IFRS 17, paragraph C9 permits insurers to make the following assessments either at the date of inception or on initial recognition of a contract provided that such assessments can be made based on reasonable and supportable evidence for what the insurer would have determined given the terms of the contract and the market conditions at that time, or at the transition date:

(a) whether a contract is eligible for the VFA;

(b) how to group contracts[5]; and

(c) how to determine the effect of discretion on estimated cash flows for contracts subject to the General Model.

24 As noted in paragraph 46, using the modified retrospective approach, insurers should not include in a group insurance contracts issued more than one year apart if reasonable and supportable information is not available.

25 The requirements in determining the CSM under this approach distinguish between the CSM (or loss components[6]) for groups of contracts without direct participation features and those with direct participation features (IFRS 17, paragraph C17).

Determination of the CSM: Groups of contracts without direct participation features

26 The permitted modifications for the measurement of such contracts focus on the determination of CSM or loss component at transition. This is calculated by, firstly, estimating the future cash flows at the transition date. Then the insurer adjusts those expected future cash flows for cash flows that are known to have occurred between initial recognition of a group of insurance contracts and the transition date.

27 The following table highlights the respective amounts to be determined for a group of contracts together with the permitted modifications available under IFRS 17, paragraphs C11-C16.

Amount to be determined for a group of contracts	Permitted modification
Future cash flows at date of initial recognition	Estimated as the future cash flows at the date of transition (*or earlier date),* adjusted for cash flows that are known to have occurred between the date of initial recognition of the group and the date of transition. Therefore if the amount can be determined retrospectively for an earlier date than the date of transition, then that amount is used.
Discount rate as at date of initial recognition	Estimated using an observable yield curve that approximates the yield curve determined under IFRS 17 for at least three years before the date of transition. If this does not exist, then the insurer applies a spread (averaged over three years before the date of transition) to an observable yield curve. The spread adjusts the observable yield curve to approximate a yield curve determined under the standard.
Risk adjustment for non-financial risk	Determined as the risk adjustment for non-financial risk at the date of transition adjusted for the expected release of risk before that date. The expected release is determined with reference to that for similar insurance contracts that the insurer issues at the date of transition.
CSM on initial recognition	The permitted modifications as described above are applied as necessary to determine the CSM on initial recognition. The amount of CSM so determined is then adjusted to: • accrete interest based on the relevant discount rates; and • reflect the transfer of services before the date of transition. This is determined by comparing the remaining coverage units with the coverage units

[5] Please refer to the EFRAG paper *Level of Aggregation* for a discussion on grouping and the annual cohort requirements. Also refer to the EFRAG paper *Release of the CSM* for the interaction of the annual cohort requirement and the CSM run off.

[6] The loss component determines the amounts that are presented in profit or loss as reversals of losses on onerous groups and are excluded from the determination of insurance revenue.

Amount to be determined for a group of contracts	Permitted modification
	provided under the group of contracts before the date of transition.
Loss component	The requirements and permitted modifications for future cash flows, discount rates and risk adjustment are applied to determine any loss component on initial recognition using a systematic basis of allocation.

28 EFRAG notes that the approach described above avoids the need for the insurer to retrospectively:

(a) estimate the cash flows at the date of initial recognition of a group of contracts; and

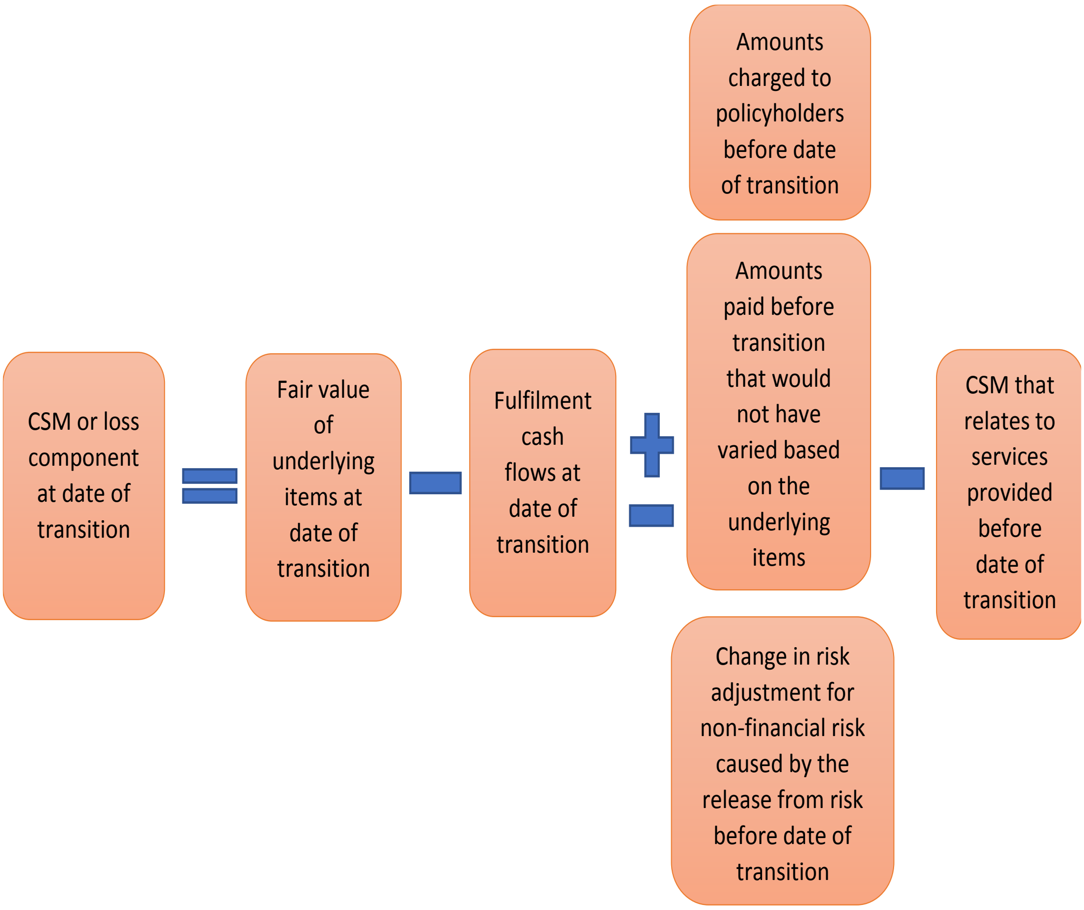
(b) measure the various adjustments that would have been made to the CSM between the date of initial recognition and the date of transition to IFRS 17 (or earlier date) if IFRS 17 had always been applied.

29 EFRAG also notes that one of the key inputs to the determination of the CSM under this transition method are the '*cash flows that are known to have occurred between the date of initial recognition of the group and the date of transition*'. As explained above, EFRAG has been made aware of a concern that, in some cases, the data available on these past cash flows may not be sufficient to ensure an estimate of the CSM at transition under the modified retrospective approach that reflects the insurer's view on profitability of these cash flows.

Determination of the CSM: Groups of contracts with direct participation features

30 The CSM or loss component for a group of contracts with direct participation features at the date of transition makes use of a proxy for the total CSM for all services (past and future) provided under the contracts (IFRS 17, paragraph C17).

31 This can be illustrated as follows:



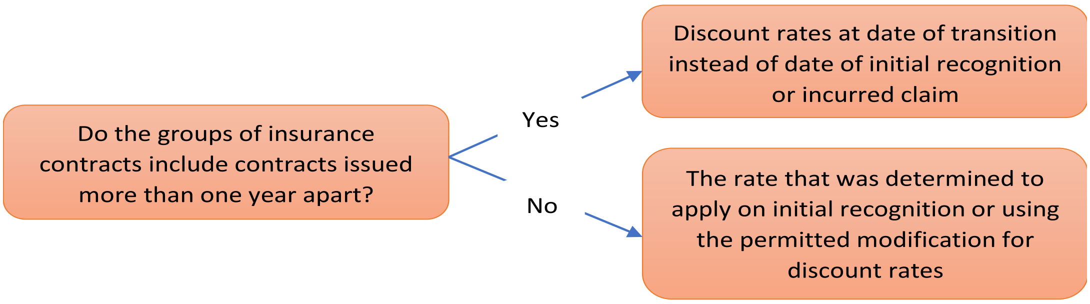
32 The amount calculated as a proxy for total CSM for all services (past and future) provided under the contracts is reduced by the CSM that relates to services provided before the date of transition. This is based on the ratio between the remaining coverage units at the date of transition and the coverage units provided under the groups of contracts before the date of transition.

Insurance finance income or expenses

Use of discount rates

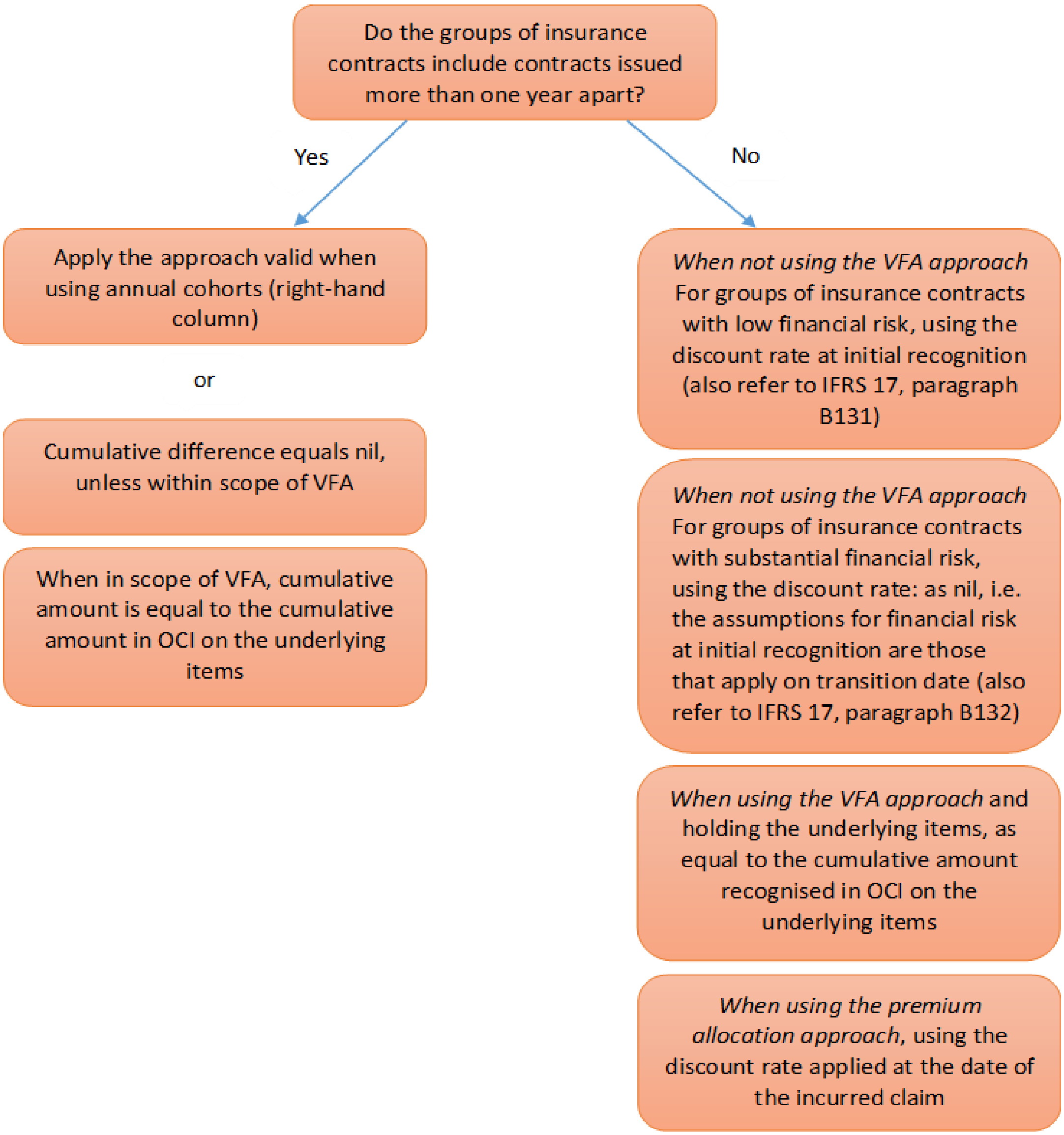
33 The discount rate used to determine insurance finance income or expense for periods subsequent to the date of transition depends on whether groups of insurance contracts at transition include contracts that were issued more than one year apart. Also refer to paragraph 43 for the annual cohort requirements under the different transition approaches.

34 This can be illustrated as follows (IFRS 17, paragraphs C18-C19):



Determining cumulative difference in OCI

35 If an insurer chooses to disaggregate insurance finance income or expenses, the cumulative amount of insurance finance income or expense recognised in other comprehensive income at transition date is determined as follows (IFRS 17, paragraph C19(b)).



Fair value approach

36 The fair value approach requires an insurer to determine the CSM or loss component at transition date for a group of contracts as the difference between the fair value of a group of insurance contracts and the fulfilment cash flows of the group measured at that date (IFRS 17, paragraph C20).

CSM at transition = Fair value − Fulfilment cash flows

37 The fair value of a group of insurance contracts is measured in accordance with IFRS 13 *Fair Value Measurement.* This fair value reflects the price that a market participant would require for taking on the obligation. In accordance with IFRS 13, paragraph 41(a), this fair value will also include the compensation that a market participant would require for accepting obligations under insurance contracts (in

other words a profit margin). Consequently, this approach can be expected to result in a CSM at transition that reflects market participants' expectations at the date of transition. If the contract was issued at a higher or lower level of profitability (e.g. due to changes in the market) then the CSM determined under the fair value approach can be expected to differ from the CSM that would be determined under a retrospective approach. Other factors, such as possible differences in the reference market for fair value estimation, the market in which individual contracts were issued and the absence of a liquid market for insurance liabilities, might also affect the outcome.

38 Applying the fair value approach, the acquisition cash flows occurring *prior* to the date of the transition (irrespective whether these are in an asset or liability position) are not included in the measurement, i.e. they are written off to equity on transition.

39 Depending on whether reasonable and supportable information is available, this transition approach allows for an insurer to determine the following requirements of the Standard either retrospectively or at transition date (IFRS 17, paragraph C21):

(a) aggregation of insurance contracts into groups;

(b) whether an insurance contract meets the definition of an insurance contract with direct participation features; and

(c) how to identify discretionary cash flows for insurance contracts without direct participation features.

40 As noted in paragraph 47, using the fair value approach, insurers are permitted but not required to include in a group insurance contracts issued more than one year apart.

41 In order to determine insurance finance income or expense for periods subsequent to the date of transition, insurers need to determine the discount rate at the date of initial application (that is, under IFRS 17, 1 January 2021). However, under the fair value approach insurers are permitted to determine the discount rate at the date of transition instead (that is, under IFRS 17, 1 January 2020). The same relief has been provided for determining the discount rates at the dates of the incurred claims for groups of insurance contracts that apply the premium allocation approach and apply the disaggregation policy choice for insurance finance income or expense (IFRS 17, paragraph C23).

42 If an insurer applies the accounting policy choice to disaggregate insurance finance income and expense in profit or loss and other comprehensive income, then the amount accumulated in other comprehensive income on transition date is (IFRS 17, paragraph C24):

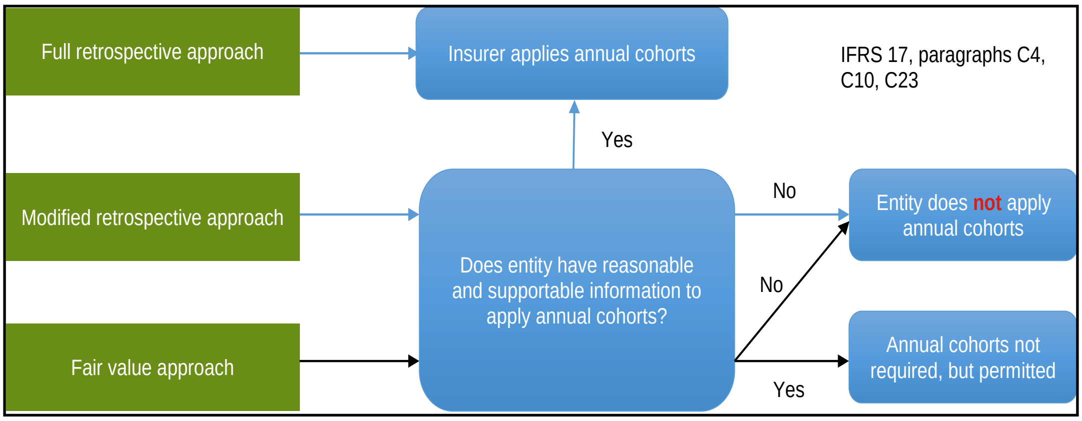
(a) determined retrospectively, if there is reasonable and supportable information available;

(b) determined as being equal to the cumulative amount of the underlying items recognised in other comprehensive income for insurance contracts with direct participation features, in cases where the insurer holds the underlying items as assets; or

(c) nil, in any other circumstances.

Use of annual cohorts upon transition

43 The following diagram provides an overview of the application of annual cohorts upon transition:



44 With regards to the grouping of contracts, IFRS 17 generally requires that only contracts issued no more than one year apart can be grouped together. This is colloquially referred to as the annual cohort requirement (Also refer to the EFRAG paper *Level of Aggregation*).

45 Under the full retrospective approach, an insurer applies IFRS 17 as if the insurer has always applied it. This includes adhering to the annual cohort requirement.

46 Under the modified retrospective approach transition relief has been provided so that insurers shall not apply the annual cohort requirement if the insurer has no reasonable and supportable information available to do so (IFRS 17, paragraph C10).

47 Under the fair value approach, insurers may apply the annual cohort requirement but are not required to do so (IFRS 17, paragraph C23).

Comparative information

48 Under all transition methods, IFRS 17 requires restatement of comparative information. As result, users of financial statements will be provided with information for the comparative period under both IFRS 4 (in the financial statements for the comparative period) and IFRS 17 (through the comparative period information in the financial statements in which IFRS 17 is first applied). The IASB decided to include this requirement because of the diversity of previous accounting and the extent of the changes introduced by IFRS 17. The IASB also expected that determining the comparative amounts would not require significant incremental time and resources beyond those required to first apply IFRS 17 (IFRS 17, paragraph BC388).

49 IFRS 9 permits, but does not require, an entity to restate prior periods if it is possible without using hindsight (IFRS 9, paragraph 7.2.15). When an insurer does not restate prior periods (either as a matter of choice or because restatement without use of hindsight is not possible), the financial statements in which IFRS 17 is first applied will include restated comparative information for insurance contracts but the associated financial assets will be reported in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.

Disclosures

50 IFRS 17 requires that the insurer provides disclosures that enable users of financial statements to identify the effect of groups of insurance contracts measured at the transition date applying the modified retrospective approach or the fair value approach on the CSM and insurance revenue in subsequent periods (IFRS 17,

paragraph 114). The provision of such recurrent disclosures is seen by some insurers as costly. In addition, the insurer is required to explain how it determined the measurement of the insurance contracts at transition date (IFRS 17, paragraph 115).

51 Insurers are able to make use of an accounting policy option to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income. When doing so, the insurer shall explain the cumulative difference between the insurance finance income or expenses that would have been reported in profit or loss and the total insurance finance income or expenses at transition date (IFRS 17, paragraph 116).

Appendix 1: Extracts from IFRS 17, IFRS 9, IFRS 13 and IAS 8 relating to Transition

Retrospective approach (paragraphs C4–C5)

C4 *To apply IFRS 17 retrospectively, an entity shall at the transition date:*
- *(a) identify, recognise and measure each group of insurance contracts as if IFRS 17 had always applied;*
- *(b) derecognise any existing balances that would not exist had IFRS 17 always applied; and*
- *(c) recognise any resulting net difference in equity.*

C5 *If, and only if, it is impracticable for an entity to apply paragraph C3 for a group of insurance contracts, an entity shall apply the following approaches instead of applying paragraph C4(a):*
- *(a) the modified retrospective approach in paragraphs C6–C19, subject to paragraph C6(a); or*
- (b) *the fair value approach in paragraphs C20–C24.*

Modified retrospective approach (paragraphs C6–C19)

C6 *The objective of the modified retrospective approach is to achieve the closest outcome to retrospective application possible using reasonable and supportable information available without undue cost or effort. Accordingly, in applying this approach, an entity shall:*
- *(a) use reasonable and supportable information. If the entity cannot obtain reasonable and supportable information necessary to apply the modified retrospective approach, it shall apply the fair value approach.*
- *(b) maximise the use of information that would have been used to apply a fully retrospective approach, but need only use information available without undue cost or effort.*

C7 *Paragraphs C9–C19 set out permitted modifications to retrospective application in the following areas:*
- *(a) assessments of insurance contracts or groups of insurance contracts that would have been made at the date of inception or initial recognition;*
- *(b) amounts related to the contractual service margin or loss component for insurance contracts without direct participation features;*
- *(c) amounts related to the contractual service margin or loss component for insurance contracts with direct participation features; and*
- *(d) insurance finance income or expenses.*

C8 *To achieve the objective of the modified retrospective approach, an entity is permitted to use each modification in paragraphs C9–C19 only to the extent that an entity does not have reasonable and supportable information to apply a retrospective approach.*

Assessments at inception or initial recognition

C9 *To the extent permitted by paragraph C8, an entity shall determine the following matters using information available at the transition date:*
- *(a) how to identify groups of insurance contracts, applying paragraphs 14–24;*
- *(b) whether an insurance contract meets the definition of an insurance contract with direct participation features, applying paragraphs B101–B109; and*
- *(c) how to identify discretionary cash flows for insurance contracts without direct participation features, applying paragraphs B98–B100.*

C10 *To the extent permitted by paragraph C8, an entity shall not apply paragraph 22 to divide groups into those that do not include contracts issued more than one year apart.*

Determining the CSM or loss component for groups of insurance contracts without direct participation feature

C11 *To the extent permitted by paragraph C8, for contracts without direct participation features, an entity shall determine the contractual service margin or loss component of the liability for* *remaining coverage (see paragraphs 49–52) at the transition date by applying paragraphs C12–C16.*

C12 *To the extent permitted by paragraph C8, an entity shall estimate the future cash flows at the date of initial recognition of a group of insurance contracts as the amount of the future cash flows at the transition date (or earlier date, if the future cash flows at that earlier date can be determined retrospectively, applying paragraph C4(a)), adjusted by the cash flows that are known to have occurred between the date of initial recognition of a group of insurance contracts and the transition date (or earlier date). The cash flows that are known to have occurred include cash flows resulting from contracts that ceased to exist before the transition date.*

C13 *To the extent permitted by paragraph C8, an entity shall determine the discount rates that applied at the date of initial recognition of a group of insurance contracts (or subsequently):*

- *(a) using an observable yield curve that, for at least three years immediately before the transition date, approximates the yield curve estimated applying paragraphs 36 and B72–B85, if such an observable yield curve exists.*
- *(b) if the observable yield curve in paragraph (a) does not exist, estimate the discount rates that applied at the date of initial recognition (or subsequently) by determining an average spread between an observable yield curve and the yield curve estimated applying paragraphs 36 and B72–B85, and applying that spread to that observable yield curve. That spread shall be an average over at least three years immediately before the transition date.*

C14 *To the extent permitted by paragraph C8, an entity shall determine the risk adjustment for non-financial risk at the date of initial recognition of a group of insurance contracts (or subsequently) by adjusting the risk adjustment for non-financial risk at the transition date by the expected release of risk before the transition date. The expected release of risk shall be determined by reference to the release of risk for similar insurance contracts that the entity issues at the transition date.*

C15 *If applying paragraphs C12–C14 results in a contractual service margin at the date of initial recognition, to determine the contractual service margin at the date of transition an entity shall:*

- *(a) if the entity applies C13 to estimate the discount rates that apply on initial recognition, use those rates to accrete interest on the contractual service margin; and*
- *(b) to the extent permitted by paragraph C8, determine the amount of the contractual service margin recognised in profit or loss because of the transfer of services before the transition date, by comparing the remaining coverage units at that date with the coverage units provided under the group of contracts before the transition date (see paragraph B119).*

C16 *If applying paragraphs C12–C14 results in a loss component of the liability for remaining coverage at the date of initial recognition, an entity shall determine any amounts allocated to the loss component before the transition date applying paragraphs C12–C14 and using a systematic basis of allocation.*

Determining the CSM or loss component for groups of insurance contracts with direct participation features

C17 *To the extent permitted by paragraph C8, for contracts with direct participation features an entity shall determine the contractual service margin or loss component of the liability for remaining coverage at the transition date as:*

- *(a) the total fair value of the underlying items at that date; minus*
- *(b) the fulfilment cash flows at that date; plus or minus*
- *(c) an adjustment for:*
  - *(i) amounts charged by the entity to the policyholders (including amounts deducted from the underlying items) before that date.*
  - *(ii) amounts paid before that date that would not have varied based on the underlying items.*
  - *(iii) the change in the risk adjustment for non-financial risk caused by the release from risk before that date. The entity shall estimate this amount by reference to*

the release of risk for similar insurance contracts that the entity issues at the transition date.

(d) if (a)–(c) result in a contractual service margin—minus the amount of the contractual service margin that relates to services provided before that date. The total of (a)–(c) is a proxy for the total contractual service margin for all services to be provided under the group of contracts, ie before any amounts that would have been recognised in profit or loss for services provided. The entity shall estimate the amounts that would have been recognised in profit or loss for services provided by comparing the remaining coverage units at the transition date with the coverage units provided under the group of contracts before the transition date; or

(e) if (a)–(c) result in a loss component—adjust the loss component to nil and increase the liability for remaining coverage excluding the loss component by the same amount.

Insurance finance income or expense

C18 For groups of insurance contracts that, applying paragraph C10, include contracts issued more than one year apart:

(a) an entity is permitted to determine the discount rates at the date of initial recognition of a group specified in paragraphs B72(b)–B72(e)(ii) and the discount rates at the date of the incurred claim specified in paragraph B72(e)(iii) at the transition date instead of at the date of initial recognition or incurred claim.

(b) if an entity chooses to disaggregate insurance finance income or expenses between amounts included in profit or loss and amounts included in other comprehensive income applying paragraphs 88(b) or 89(b), the entity needs to determine the cumulative amount of insurance finance income or expenses recognised in other comprehensive income at the transition date to apply paragraph 91(a) in future periods. The entity is permitted to determine that cumulative difference either by applying paragraph C19(b) or:

(i) as nil, unless (ii) applies; and

(ii) for insurance contracts with direct participation features to which paragraph B134 applies, as equal to the cumulative amount recognised in other comprehensive income on the underlying items.

C19 For groups of insurance contracts that do not include contracts issued more than one year apart:

(a) if an entity applies paragraph C13 to estimate the discount rates that applied at initial recognition (or subsequently), it shall also determine the discount rates specified in paragraphs B72(b)–B72(e) applying paragraph C13; and

(b) if an entity chooses to disaggregate insurance finance income or expenses between amounts included in profit or loss and amounts included in other comprehensive income, applying paragraphs 88(b) or 89(b), the entity needs to determine the cumulative amount of insurance finance income or expenses recognised in other comprehensive income at the transition date to apply paragraph 91(a) in future periods. The entity shall determine that cumulative difference:

(i) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B131—if the entity applies paragraph C13 to estimate the discount rates at initial recognition—using the discount rates that applied at the date of initial recognition, also applying paragraph C13;

(ii) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B132—on the basis that the assumptions that relate to financial risk that applied at the date of initial recognition are those that apply on the transition date, ie as nil;

(iii) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B133—if the entity applies paragraph C13 to estimate the discount rates initial recognition (or subsequently)—using the discount rates that applied at the date of the incurred claim, also applying paragraph C13; and

(iv) for insurance contracts with direct participation features to which paragraph B134 applies—as equal to the cumulative amount recognised in other comprehensive income on the underlying items.

Fair value approach (paragraphs C20–C24)

C20 To apply the fair value approach, an entity shall determine the contractual service margin or loss component of the liability for remaining coverage at the transition date as the difference between the fair value of a group of insurance contracts at that date and the fulfilment cash flows measured at that date. In determining that fair value, an entity shall not apply paragraph 47 of IFRS 13 Fair Value Measurement (relating to demand features).

C21 In applying the fair value approach, an entity may apply paragraph C22 to determine:

(a) how to identify groups of insurance contracts, applying paragraphs 14–24;

(b) whether an insurance contract meets the definition of an insurance contract with direct participation features, applying paragraphs B101–B109; and

(c) how to identify discretionary cash flows for insurance contracts without direct participation features, applying paragraphs B98–B100.

C22 An entity may choose to determine the matters in paragraph C21 using:

(a) reasonable and supportable information for what the entity would have determined given the terms of the contract and the market conditions at the date of inception or initial recognition, as appropriate; or

(b) reasonable and supportable information available at the transition date.

C23 In applying the fair value approach, an entity is not required to apply paragraph 22, and may include in a group contracts issued more than one year apart. An entity shall only divide groups into those including only contracts issued within a year (or less) if it has reasonable and supportable information to make the division. Whether or not an entity applies paragraph 22, it is permitted to determine the discount rates at the date of initial recognition of a group specified in paragraphs B72(b)–B72(e)(ii) and the discount rates at the date of the incurred claim specified in paragraph B72(e)(iii) at the transition date instead of at the date of initial recognition or incurred claim.

C24 In applying the fair value approach, if an entity chooses to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income, it is permitted to determine the cumulative amount of insurance finance income or expenses recognised in other comprehensive income at the transition date:

(a) retrospectively—but only if it has reasonable and supportable information to do so; or

(b) as nil—unless (c) applies; and

(c) for insurance contracts with direct participation features to which paragraph B134 applies—as equal to the cumulative amount recognized in other comprehensive income from the underlying items

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38 The contractual service margin is a component of the asset or liability for the group of insurance contracts that represents the unearned profit the entity will recognise as it provides services in the future. An entity shall measure the contractual service margin on initial recognition of a group of insurance contracts at an amount that, unless paragraph 47 (on onerous contracts) applies, results in no income or expenses arising from:

(a) the initial recognition of an amount for the fulfilment cash flows, measured by applying paragraphs 32–37;

(b) the derecognition at the date of initial recognition of any asset or liability recognised for insurance acquisition cash flows applying paragraph 27; and

(c) any cash flows arising from the contracts in the group at that date.

114 An entity shall provide disclosures that enable users of financial statements to identify the effect of groups of insurance contracts measured at the transition date applying the modified retrospective approach (see paragraphs C6–C19) or the fair value approach (see paragraphs C20–C24) on the contractual service margin and insurance revenue in subsequent periods. Hence an entity shall disclose the reconciliation of the contractual service margin applying paragraph 101(c), and the amount of insurance revenue applying paragraph 103(a), separately for:

(a) insurance contracts that existed at the transition date to which the entity has applied the modified retrospective approach;

(b) insurance contracts that existed at the transition date to which the entity has applied the fair value approach; and

(c) all other insurance contracts.

115 For all periods in which disclosures are made applying paragraphs 114(a) or 114(b), to enable users of financial statements to understand the nature and significance of the methods used and judgements applied in determining the transition amounts, an entity shall explain how it determined the measurement of insurance contracts at the transition date.

116 An entity that chooses to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income applies paragraphs C18(b), C19(b), C24(b) and C24(c) to determine the cumulative difference between the insurance finance income or expenses that would have been recognised in profit or loss and the total insurance finance income or expenses at the transition date for the groups of insurance contracts to which the disaggregation applies. For all periods in which amounts determined applying these paragraphs exist, the entity shall disclose a reconciliation from the opening to the closing balance of the cumulative amounts included in other comprehensive income for financial assets measured at fair value through other comprehensive income related to the groups of insurance contracts. The reconciliation shall include, for example, gains or losses recognised in other comprehensive income in the period and gains or losses previously recognised in other comprehensive income in previous periods reclassified in the period to profit or loss.

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B115 To the extent that an entity meets the conditions in paragraph B116, it may choose not to recognise a change in the contractual service margin to reflect some or all of the changes in the effect of financial risk on the entity's share of the underlying items (see paragraph B112) or the fulfilment cash flows set out in paragraph B113(b).

B131 For groups of insurance contracts for which changes in assumptions that relate to financial risk do not have a substantial effect on the amounts paid to the policyholder, the systematic allocation is determined using the discount rates specified in paragraph B72(e)(i).

B132 For groups of insurance contracts for which changes in assumptions that relate to financial risk have a substantial effect on the amounts paid to the policyholders:

(a) a systematic allocation for the finance income or expenses arising from the estimates of future cash flows can be determined in one of the following ways:

(i) using a rate that allocates the remaining revised expected finance income or expenses over the remaining duration of the group of contracts at a constant rate; or

(ii) for contracts that use a crediting rate to determine amounts due to the policyholders—using an allocation that is based on the amounts credited in the period and expected to be credited in future periods.

(b) a systematic allocation for the finance income or expenses arising from the risk adjustment for non-financial risk, if separately disaggregated from other changes in the risk adjustment for non-financial risk applying paragraph 81, is determined using an allocation consistent with that used for the allocation for the finance income or expenses arising from the future cash flows.

(c) a systematic allocation for the finance income or expenses arising from the contractual service margin is determined:

(i) for insurance contracts that do not have direct participation features, using the discount rates specified in paragraph B72(b); and

(ii) for insurance contracts with direct participation features, using an allocation consistent with that used for the allocation for the finance income or expenses arising from the future cash flows.

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BC372 IFRS 17 includes specific requirements for applying the Standard for the first time. An entity is therefore required to apply the IFRS 17 transition requirements instead of the general requirements of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. In the light of the diversity in previous insurance accounting practices and the long duration of many types of insurance contracts, the Board decided that retrospective application of IFRS 17 provides the *most useful information to users of financial statements by allowing comparisons between contracts written before and after the date of initial application of the Standard. Consistent with IAS 8, which requires retrospective application of a new accounting policy except when it would be impracticable, the Board concluded that entities should apply IFRS 17 retrospectively (see paragraphs BC374–BC378) and should be allowed to use alternatives only when retrospective application of IFRS 17 is impracticable.*

BC374 To apply IFRS 17 retrospectively, at the transition date an entity is required to:

- *(a) recognise and measure each group of insurance contracts as if IFRS 17 had always applied;*
- *(b) derecognise any existing balances that would not exist had IFRS 17 always applied; and*
- *(c) recognise any resulting net difference in equity.*

Consistent with retrospective application, the Board noted that an entity would need not only to adjust the measurement of its insurance contracts when first applying the Standard but also to eliminate any items such as deferred acquisition costs and some intangible assets that relate solely to existing contracts. The requirement to recognise any resulting net differences in equity means that no adjustment is made to the carrying amount of goodwill from any previous business combinations.

BC375 The measurement model in IFRS 17 comprises two components:

- *(a) a direct measurement, which is based on estimates of the present value of future cash flows and an explicit risk adjustment for non-financial risk; and*
- *(b) a contractual service margin, which is measured on initial recognition of the group of insurance contracts, then adjusted for subsequent changes in estimates relating to future service and adjusted for subsequent changes in estimates relating to future services and a financing component and recognised in profit or loss over the coverage period.*

BC376 The Board identified no specific transition problems for the introduction of the direct measurement component of the insurance contracts, other than in the assessments made on initial recognition described in paragraphs BC381–BC382. That measurement reflects only circumstances at the measurement date. Consequently, provided an entity has sufficient lead time to set up the necessary systems, performing that direct measurement at the transition date will be no more difficult than performing it at a later date.

BC377 Measuring the remaining amount of the contractual service margin at the transition date, and the information needed for presentation in the statement(s) of financial performance in subsequent periods, is more challenging. These amounts reflect a revision of estimates for all periods after the initial recognition of the group of insurance contracts.

BC378 The Board concluded that measuring the following amounts needed for retrospective application would often be impracticable:

- *(a) the estimates of cash flows at the date of initial recognition;*
- *(b) the risk adjustment for non-financial risk at the date of initial recognition;*
- *(c) the changes in estimates that would have been recognised in profit or loss for each accounting period because they did not relate to future service, and the extent to which changes in the fulfilment cash flows would have been allocated to the loss component;*
- *(d) the discount rates at the date of initial recognition; and*
- *(e) the effect of changes in discount rates on estimates of future cash flows for contracts for which changes in financial assumptions have a substantial effect on the amounts paid to policyholders.*

The Board therefore developed two transition methods entities are allowed to use for groups of insurance contracts for which retrospective application of IFRS 17 would be impracticable.

BC388 The Board concluded that providing restated comparative information for at least one reporting period was necessary because of the diversity of previous accounting and the extent of the changes introduced by IFRS 17. Because IFRS 17 only requires retrospective application on transition if practicable, and specifies simplified approaches when retrospective application is impracticable, the Board expects that determining the comparative amounts will not require significant incremental time and resources beyond those required to first apply IFRS 17. The Board set the effective date for IFRS 17 based on information given about the necessary time to prepare, in the knowledge that restated comparative information for one reporting period would be required.

BC 393 Paragraph B115 of IFRS 17 permits entities not to recognise a change in the contractual service margin for changes in fulfilment cash flows and the entity's share in the fair value returns on underlying items for which an entity uses derivatives to mitigate their financial risk. However, an entity applying this option is required to document its risk management objective and the strategy for mitigating the risk before doing so. This documentation requirement is analogous to the documentation requirements for hedge accounting in IFRS 9. Consistent with the transition requirements for hedge accounting in IFRS 9, the Board concluded that retrospective application of the risk mitigation treatment would give rise to the risk of hindsight. In particular, the Board was concerned that documentation after the event could enable entities to choose the risk mitigation relationships to which it would apply this option, particularly because the application of this approach is optional. Consequently, IFRS 17, consistent with the transition requirements for hedge accounting in IFRS 9, requires prospective application of the risk mitigation option from the date of initial application of the Standard.

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IFRS 9 Financial Instruments

7.2.15 Despite the requirement in paragraph 7.2.1, an entity that adopts the classification and measurement requirements of this Standard (which include the requirements related to amortised cost measurement for financial assets and impairment in Sections 5.4 and 5.5) shall provide the disclosures set out in paragraphs 42L–42O of IFRS 7 but need not restate prior periods. The entity may restate prior periods if, and only if, it is possible without the use of hindsight. If an entity does not restate prior periods, the entity shall recognise any difference between the previous carrying amount and the carrying amount at the beginning of the annual reporting period that includes the date of initial application in the opening retained earnings (or other component of equity, as appropriate) of the annual reporting period that includes the date of initial application. However, if an entity restates prior periods, the restated financial statements must reflect all of the requirements in this Standard. If an entity's chosen approach to applying IFRS 9 results in more than one date of initial application for different requirements, this paragraph applies at each date of initial application (see paragraph 7.2.2). This would be the case, for example, if an entity elects to early apply only the requirements for the presentation of gains and losses on financial liabilities designated as at fair value through profit or loss in accordance with paragraph 7.1.2 before applying the other requirements in this Standard.

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IFRS 13 Fair Value Measurement

41 For example, when applying a present value technique an entity might take into account either of the following:

a) the future cash outflows that a market participant would expect to incur in fulfilling the obligation , including the compensation that a market participant would requires for taking on the obligation (see paragraphs B31-B33);

b) …

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IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors

5 Impracticable: Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

a) the effects of the retrospective application or retrospective restatement are not determinable;

b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or

c) the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:

a. provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognized, measured or disclosed; and
b. would have been available when the financial statements for that prior period were authorized for issue from other information.

28 When initial application of an IFRS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:
…..
(f) for the current period and each prior period presented, to the extent practicable, the amount or the adjustment:

(i) For each financial statement line item affected; and
(ii) If IAS 33 Earnings per Share applies to the entity, for basic and diluted earnings per share.

Appendix 2: Extracts from IFRS 17 relating to other aspects

Definitions as per IFRS 17 Appendix A

Insurance contract with direct participation features

An insurance contract for which, at inception:

(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.

Investment contract with discretionary participation features

A financial instrument that provides a particular investor with the contractual right to receive, as a supplement to an amount not subject to the discretion of the issuer, additional amounts:

(a) that are expected to be a significant portion of the total contractual benefits;

(b) the timing or amount of which are contractually at the discretion of the issuer; and

(c) that are contractually based on:

(i) the returns on a specified pool of contracts or a specified type of contract;

(ii) realised and/or unrealised investment returns on a specified pool of assets held by the issuer; or

(iii) the profit or loss of the entity or fund that issues the contract.

insurance acquisition cash flows

*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.*