IFRS 17 Insurance Contracts
Update on the Project

Objective and Introduction

1 The objective of this paper is to provide EFRAG TEG members with an update on the IASB's tentative decisions from the February IASB meeting and to provide a summary of the discussions held at the ASAF meeting.

2 The ASAF met on 6th March 2017 to discuss how the members could support the implementation of IFRS 17 *Insurance Contracts* ('IFRS 17').

3 This paper provides a summary of the following three papers discussed in February:

(a) IASB paper 2A – Changes to the contractual service margin (Agenda paper 07-02);

(b) IASB paper 2B – Narrow exemption for the grouping of regulatory–affected pricing of insurance contracts (Agenda paper 07-03); and

(c) IASB paper 2C – Responding to external editorial review (Agenda paper 07-04).

4 The IASB Board's tentative decisions published in the IASB update are presented as an Appendix to this paper.

IASB next steps

5 Based on an oral update at the IASB meeting of 21 March 2017, IFRS 17 is expected to be published in the second half of May 2017. Also, the IASB will set up a Transition Resource Group ('TRG') and a public call for candidates for this TRG will be done close to the IFRS 17 publication date.

IASB paper 2A – Changes to the contractual service margin

General model - changes in estimates of future cash flows that are directly caused by experience adjustments

6 **In November 2016**, the IASB Board tentatively decided that when an experience adjustment directly causes a change in the estimate of the present value of future cash flows, the combined effect of the experience adjustment and the change in the estimate of the present value of the future cash flows should **be recognised in profit or loss** rather than adjusting the contractual service margin ('CSM').

7 The IASB Board's objective of combining the effect of an experience adjustment and any directly caused changes in estimates of the present value of future cash flows was to avoid the recognition of a loss or gain in the current period and a consequential gain or loss in future periods when a claim is incurred earlier or later than expected. This tentative decision was based on the idea that both effects were offsetting each other, i.e., if the experienced adjustment has a negative effect in P&L

the changes in estimate related to future coverage would have a positive impact, consequently both should be in P&L.

	Future coverage	**Current or past services**
Changes in estimates related to the future for non – financial risks	CSM	-
Experience adjustment related to non – financial risks	-	P&L
Combined effect experience adjustments/changes in estimates	P&L	

8 Subsequent to its November 2016 meeting, the IASB Board had received concerns about this IASB tentative decision. One of the concerns was that there appeared to be a very grey line between what adjusts the CSM and what goes directly to profit or loss. Another concern was that the requirement would add operational complexity because it would require the adjustments to insurance contract revenue (and insurance service expenses) to be recorded and tracked in future periods.

9 Additionally, IASB subsequently realised that there could be situations where this combined effect is not being off-set.

10 Therefore, acknowledging both concerns raised, the IASB, **in its February 2017 meeting**, changed its November 2016 tentative decisions as follows:

	Future coverage	**Current or past services**
Changes in estimates related to the future for non – financial risks	CSM	-
Experience adjustment related to non – financial risks	-	P&L
Combined effect experience adjustments/changes in estimates	CSM	

11 The EFRAG Secretariat acknowledges that a change in estimates of future cash flows is directly caused by an experience adjustment only when an experienced adjustment causes a change in **future** rights and obligations. Thus, the EFRAG Secretariat agrees with February 2017 IASB's tentative decisions because it is aligned with the main principle that changes affecting future coverage impact CSM.

Definition of an experience adjustment

12 According to paragraph 25 of IASB Staff paper 2A, an experience adjustment was defined in the second pre-ballot draft as a difference between (i) the most recent previous assumptions about cash flows and incurred claims and expenses in the period and (ii) actual cash flows and incurred claims and expenses in the period.

13 As a result, a delay or acceleration in the repayment of an investment component could result in a gain or loss being recognised in one period with an off-setting loss or gain in subsequent periods if the effects of an experience adjustment and changes in the estimate of the present value of future cash flows are not combined.

14 In order to resolve this issue, the IASB tentatively decided to change the definition of an experience adjustment to exclude investment components.

General model – determination of the amount recognised in profit or loss to reflect the services provided in the period

15 Some feedback was received by the IASB that the allocation of the CSM, for a group of insurance contracts, to coverage units[1] in the current period should be determined **before** the amount of the CSM for the group of contracts and the number of coverage units provided in future periods are updated to reflect the changes in non-financial assumptions that are not directly caused by an experience adjustment. They considered that the fulfilment cash flows for a group of insurance contracts is a prospective measurement and should not have any impact on the accretion of CSM recognised in profit or loss in the current period. Also, management could defer making a change in a non-financial assumption until the beginning of the next accounting period, in order to avoid recognising the effect of the change in the current period.

16 However, the IASB tentatively decided that the amount of the CSM recognised in profit or loss in each period is determined by allocating the carrying amount of the CSM **after** all other adjustments have been made to the carrying amount of the CSM at the start of the period. One of the reasons is because, if done otherwise, there would be operational complexity due to the running of actuarial models both before and after making the changes in estimates of the present value of future cash flows that are not directly caused by experience adjustments.

Contracts measured under the Variable Fee approach

17 To be consistent with the IASB tentative decisions for the General model in paragraph 10 above, the IASB also tentatively decided that the CSM for a group of contracts measured under the Variable Fee approach should also be adjusted for all changes in estimates of the present value of future cash flows that are not related to the underlying items.

IASB paper 2B – Narrow exemption for the grouping of regulatory–affected pricing of insurance contracts

18 In some jurisdictions, law or regulation constrains the entity's ability to set the pricing and benefits paid in a way that reflects the different characteristics of individual policyholders.

19 The EFRAG Secretariat acknowledges that when differences in a particular characteristic (e.g. geographical location, age, credit history) are associated with different degrees of risk and/or estimates of claims, entities would typically charge different prices to seek compensation for those differences.

20 The EFRAG Secretariat also acknowledges that if a law or regulation constrains the pricing and benefits that an insurer can pay to a policyholder this could result, for example, with female and male contracts allocated separately in one of the three groups determined by the Standard - onerous at inception, not significantly likely to be onerous, and other contracts.

21 In order to avoid this, the IASB Board tentatively decided in February 2016 that an entity should be exempt from the requirement to divide a portfolio into these 3 groups if, and only if, applying that requirement would result in the entity dividing the contracts of a portfolio into such groups because there are specific constraints in law or regulation on an entity's practical ability to set price or benefit levels that vary

[1] Allocation based on expected duration and size of contracts in the group.

according to policyholder characteristics. Consequently, the entity may include those contracts in the same group disclosing that fact.

22 IASB paper 2B also provides some guidance about what is not a law or a regulation constraint. They are not:

(a) Self-regulatory practices;

(b) Self-constraints because of similar practices in different jurisdictions;

(c) Reputational self-constraints; or

(d) Self-constraint because a practice may create undesirable precedent.

IASB paper 2C – Responding to external editorial review

23 IASB Staff Paper 2C (Agenda paper 07-04) that relates to responding to the external editorial review summarises issues that have arisen in the external editorial review process.

24 The conclusion of this discussion was that IASB members had no other topics for discussion at a future meeting. Unless further sweep issues emerge, it is unlikely that the IASB will discuss further technical issues in this project before IFRS 17 is issued.

Question for EFRAG TEG

25 Does EFRAG TEG have any comments relating to the IASB's February 2017 tentative decisions?

Discussions held at the ASAF meeting March 2017

IASB implementation support

26 The intention of the IASB to provide educational material was welcomed, however there was also a risk that such educational material could be read as binding. One ASAF member thought that educational material was to benefit users more than preparers. But several others asked for educational material that would help preparers, such as aggregating insurance contracts or deciding on which discount rates to use. For users it would be important to focus on explaining the insurance business and what IFRS 17 is designed to accomplish.

27 Several ASAF members noted that they have local industry groups in place which could feed implementation issues to the IASB and the TRG. The TRG had a crucial role in collecting all these issues, with the aim of avoiding different interpretations of the Standard. EFRAG expected its Insurance Accounting Working Group to actively contribute in identifying issues for EFRAG to submit to the TRG.

28 The EFRAG Secretariat welcomes the provision of educational material by the IASB, as it will help in enhancing the understanding of the future Standard.

Transition resource group

29 Several ASAF members noted the different starting points of insurance companies in transitioning to IFRS 17, hence the planned Transition Resource Group ('TRG') was considered to play an essential role in building a common understanding. The IASB explained that issues would be discussed publicly at the TRG, subsequent to which action could follow from the IASB Board and/or the IFRS Interpretations Committee. The composition of the TRG would have to be geographically balanced and be composed of both accountants and actuaries.

30 Any necessary interpretation of the wording was seen as an issue to be handled by the TRG. The IASB had intentionally provided a very narrow scope regarding the regulatory exemption to the aggregation principles (see paragraphs 17-21).

31 The EFRAG Secretariat supports the establishment of a TRG as a practical way of building a common understanding of the standard, taking into account industry practice and actuarial experience from all over the world.

Release of the CSM

32 One ASAF member raised a concern that forthcoming IFRS 17 would require the contractual service margin ('CSM') to have to be released in a linear way for all insurance contracts and that this was not deemed appropriate for particular insurance contracts. The ASAF member did not explain why a linear release was a problem during the meeting.

33 IFRS 17 is expected to require that the allocation of the contractual service margin to profit or loss will be based upon the passage of time, as an insurance entity provides services under the insurance contract. In particular, the allocation shall be based on coverage units, reflecting the expected duration and size of the contracts in the group.

34 The EFRAG Secretariat notes that in a long-term insurance contract, providing service implies *standing ready to pay out* claims during the life of the contract. In the following example, the EFRAG Secretariat considers a linear allocation pattern of CSM to profit or loss will occur when assuming the following (Example 1):

(a) No discounting;

(b) All contracts in the group have an equal duration, i.e. five years;

(c) There are 100 contracts in the group of contracts which have the same size;

(d) No unexpected events occur and there are no estimated deaths over the five years;

(e) CSM at inception is CU 100.

35 The formula for the CSM allocation to profit or loss used in this example is composed as follows:

(a) Numerator: opening balance CSM of the period * number of coverage units at start of the year;

(b) Denominator: sum of coverage units where service has been provided in the current period and expected coverage units where service will be provided in the future.

36 The EFRAG Secretariat acknowledges that other mathematical methods may exist to allocate CSM to P&L over time.

37 In Example 1, the CSM allocation in Year 20X1 is computed as (100*100)/(100+100+100+100+100) = CU 20.

Example 1 - No deaths estimated and no actual deaths

	number of coverage units (estimated and actual)		100	100	100	100	100
CSM	Actual roll-forward	Inception	20X1	20X2	20X3	20X4	20X5
	Opening balance	100	100	80	60	40	20
	P&L allocation	-	(20)	(20)	(20)	(20)	(20)
	Closing balance	**100**	**80**	**60**	**40**	**20**	**-**

38 When unexpected events would happen during the coverage period, there would be no linear release of the CSM. Refer to Example 2 below.

Example 2 - Unexpected deaths in years 20X2 (at end of year) and 20X4 (at start of year)

	Estimated number of coverage units each year		100	100	80	80	70
	Actual number of coverage units at start of year		100	100	80	70	70
	Unexpected deaths *		-	20	-	10	-
	Expected deaths		-	-	-	-	-
CSM	Actual roll-forward	Inception	20X1	20X2	20X3	20X4	20X5
	Opening balance	100	100	80	56	37	19
	P&L allocation	-	(20)	(24)	(19)	(19)	(19)
	Closing balance	**100**	**80**	**56**	**37**	**19**	**-**

* In year 20X2 death at end of year and in year 20X4 death at start of year

39 When there are estimated deaths made at inception, there would also be no linear release of the CSM. Refer to Example 3 below.

Example 3 - Expected deaths in years 20X2 (at end of year) and 20X4 (at start of year)

	Estimated number of coverage units each year		100	80	80	70	70
	Actual number of coverage units at start of year		100	100	80	70	70
	Unexpected deaths		-	-	-	-	-
	Expected deaths *		-	20	-	10	-
CSM	Actual roll-forward	Inception	20X1	20X2	20X3	20X4	20X5
	Opening balance	100	100	76	52	33	17
	P&L allocation	-	(24)	(24)	(19)	(17)	(17)
	Closing balance	**100**	**76**	**52**	**33**	**17**	**-**

* In year 20X2 death at end of year and in year 20X4 death at start of year

40 However, for some insurance contracts, all or most claims are being paid at the end of the contract, for example life insurance contracts. In those circumstances, some argue that the CSM should not (or to a lesser extent) be allocated to P&L in the early years of the contract, building up reserves to be released at the moment of claims occurring. Refer to Example 4 below.

Example 4 - Unexpected or expected death in year 20X5 (at end of year)

	Estimated number of coverage units each year		100	100	100	100	70
	Actual number of coverage units at start of year		100	100	100	100	100
	Actual deaths *		-	-	-	-	30
CSM	Actual roll-forward	Inception	20X1	20X2	20X3	20X4	20X5
	Opening balance	100	100	80	60	40	20
	P&L allocation	-	(20)	(20)	(20)	(20)	(20)
	Closing balance	**100**	**80**	**60**	**40**	**20**	**-**

* In year 20X5 death at end of year

41 The EFRAG Secretariat assesses that insurance revenue is not determined by the allocation of CSM alone. When claims are expected to occur at the very last day of the entire contract period, the insurance provision should cater for that and will be released accordingly as insurance revenue.

IASB effects analysis

42 One ASAF member asked the IASB to undertake an effects analysis, both under normal economic conditions and in stress conditions in order to check any intended and unintended consequences.

43 The IASB staff explained that on an extensive effects analysis is under development and pointed out the different starting points for insurance companies make an overall view – and quantitative impact – very difficult. The IASB will not include a quantitative impact in its effects analysis.

44 Given the different starting points of every insurance entity, the EFRAG Secretariat understands the difficulties of drawing general conclusions from including quantitative estimates in the effects analysis. To fill this void for European entities, the EFRAG Secretariat is planning a case study approach, where on an entity by entity basis, impacts can be estimated.

Question for EFRAG TEG

45 Does EFRAG TEG have any comments relating to the summary of the March ASAF discussions?

Appendix – Summary of the February IASB's tentative decisions

1 The Board met on 22 February 2017 to discuss the findings from a recent external editorial review of a draft of IFRS 17 *Insurance Contracts* and sweep issues. Below are the IASB's tentative decisions as a result of the meeting.

Changes to the contractual service margin (Agenda Paper 2A)

2 The IASB Board tentatively decided:

(a) for contracts measured under the general model—that all changes in estimates of the present value of future cash flows arising from nonfinancial risks are adjusted against the contractual service margin.

(b) for contracts measured under the variable fee approach—that all changes in estimates of the present value of future cash flows that are unrelated to the underlying items and that arise from nonfinancial risks are adjusted against the contractual service margin.

(c) that the changes in estimates adjusted against the contractual service margin include changes directly caused by experience adjustments. There are two exceptions: (i) where the change relates to incurred claims, and (ii) where any increases in estimates exceed the carrying amount of the contractual service margin, or any decreases are allocated to a loss component.

(d) to revise the definition of an experience adjustment to exclude investment components.

(e) that the amount of the contractual service margin for a group of insurance contracts recognised in profit or loss in each period is determined by allocating the carrying amount of the contractual service margin after all other adjustments have been made to the carrying amount of the contractual service margin at the start of the period.

All 12 IASB Board members agreed with these decisions.

Narrow exemption for the grouping of regulatory affected pricing of insurance contracts (Agenda Paper 2B)

3 The IASB Board tentatively decided that an entity should be exempt from the requirement to divide a portfolio into groups of contracts—a group that is onerous at inception, not significantly likely to be onerous, and other contracts—if, and only if, applying that requirement would result in the entity dividing the contracts of a portfolio into such groups because there are specific constraints in law or regulation on an entity's practical ability to set price or benefit levels that vary according to policyholder characteristics. When this is the case, the entity may include those contracts in the same group and should disclose that fact. This exemption should not be extended by analogy to any other regulatory affected transactions.

Eleven of 12 IASB Board members agreed and one disagreed with this decision.

Responding to the external editorial review (Agenda Paper 2C)

4 All 12 IASB Board members agreed with the recommendations in Agenda Paper 2C on the remaining sweep issues. The IASB Board members did not raise any other topics for consideration at a future meeting.