IFRS 17 Insurance Contracts
Transition Resource Group issues

Objective and Introduction

1 The objective of this session is for EFRAG TEG to consider:

(a) the IFRS 17 *Insurance Contracts* Transition Resource Group ('TRG') issues that were discussed at the TRG meeting on 6 February 2018; and

(b) whether there are implications on the draft endorsement advice for IFRS 17.

2 The IFRS 17 TRG topics discussed were:

(a) Separation of insurance components of a single contract (IASB paper AP01);

(b) Boundary of contracts with annual repricing mechanisms (IASB paper AP02);

(c) Boundary of reinsurance contracts held (IASB paper AP03);

(d) Insurance acquisition cash flows paid on an initially written contract (IASB paper AP04);

(e) Determining quantity of benefits for identifying coverage units (IASB paper AP05);

(f) Insurance acquisition cash flows when using fair value transition (IASB paper AP06); and

(g) Reporting on other questions submitted (IASB paper AP07).

3 EFRAG IAWG discussed these topics at its meetings in January and February 2018.

4 Agenda paper 09-13 is an IASB summary of the February TRG discussions.

5 Below is a summary of the TRG topics.

Agenda Papers

6 In addition to this paper, the agenda papers associated with this paper are:

(a) Agenda paper 09-05 – TRG paper on Separation of insurance components of a single contract (for background information);

(b) Agenda paper 09-06 – TRG paper on Boundary of contracts with annual repricing mechanisms (for background information);

(c) Agenda paper 09-07 – TRG paper on Boundary of reinsurance contracts held (for background information);

(d) Agenda paper 09-08 – TRG paper on Insurance acquisition cash flows paid on an initially written contract (for background information);

(e) Agenda paper 09-09 – TRG paper on Determining quantity of benefits for identifying coverage units (for background information);

(f) Agenda paper 09-10 – TRG paper on Insurance acquisition cash flows when using fair value transition (for background information);

(g) Agenda paper 09-11 – TRG paper on Reporting on other questions submitted (for background information);

(h) Agenda paper 09-12 – TRG submissions log (for background information); and

(i) Agenda paper 09-13 – IASB's meeting summary (for background information).

IASB paper AP01 - Separation of insurance components of a single contract (Agenda paper 09-05)

IFRS 17 requirement

7 IFRS 17 identifies a contract as an agreement that creates enforceable rights and obligations. IFRS 17 does not provide specific requirements on separating enforceable rights and obligations of a contract except with respect to non-insurance components.

What is the issue?

8 Insurers combine different types of products or coverages that have different risks into one legal insurance contract[1]. The submitter questions whether IFRS 17 permits the separation of insurance components of a single contract for measurement purposes.

9 In addition, the submitter also questions whether reinsurance contracts held should be separated into components to reflect the underlying contracts covered for measurement purposes when applying IFRS 17.

10 The submitter notes several concerns if there is no separation of components contained within a single legal contract:

(a) Components that cover different risks would be forced into the same portfolio when they could be in different portfolios;

(b) Components that cover different risks would be measured using one model, when they could be measured using different measurement models[2]; and

(c) Profit that is related to the component with a shorter coverage period would be spread over the longer coverage period of a different component.

11 The submission provides five alternative views:

(a) View A – separation is not permitted under IFRS 17.

(b) View B – separation is permitted where the components are determined to be distinct[3].

(c) View C – separation is permitted using a principle-based approach.

(d) View D – applying paragraphs 10-11[4] of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, both view B and C should be acceptable.

(e) View E – IFRS 17 requires separation of insurance components that would fall into different portfolios had they been sold separately and considered

[1] For example, a term life insurance coverage and a medical expenses coverage that are included in a single contract

[2] For example, the General Model and the Premium Allocation Approach.

[3] The submission states that 'distinct' is assessed by applying the requirements in IFRS 17 for non-insurance components (B31-B35) or paragraphs 26-30 of IFRS 15 Revenue from Contracts with Customers by analogy.

[4] Paragraphs 10-11 of IAS 8 require the use of judgment in developing and applying an accounting policy in the absence of an IFRS that specifically applies to a transaction, other event, or condition.

distinct. The submission acknowledges the absence of such requirements in IFRS 17 and considers view E difficult to support.

IASB staff analysis

12 The IASB staff observe that the lowest unit of account that is used under IFRS 17 is the contract that includes all insurance components. It is expected that entities would usually design contracts in a way that reflects their substance. Therefore, a contract with the legal form of a single contract would generally be considered a single contract in substance.

13 The IASB staff acknowledge that there might be circumstances where the legal form of a single contract would not reflect the substance of its contractual rights and contractual obligations. However, the IASB staff's view is that separating insurance components of a single insurance contract involves significant judgment and careful consideration of all relevant facts and circumstances.

14 The IASB staff view is that combining different types of products or coverages that have different risks into one legal insurance contract is not, in itself, sufficient to conclude that the contract does not reflect the substance of its contractual rights and contractual obligations.

15 Similarly, the IASB staff view is that a reinsurance contract held covering underlying contracts that are included in different groups is not in itself, sufficient to conclude that the reinsurance contract held does not reflect the substance of its contractual rights and contractual obligations.

IASB paper AP02 - Boundary of contracts with annual repricing mechanisms (Agenda paper 09-06)

IFRS 17 requirement

16 IFRS 17 paragraph 33 states that all future cash flows within the boundary of each contract in a group of insurance contracts shall be included in the measurement of that group.

17 IFRS 17 paragraph 34 states:

'*Cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity can compel the policyholder to pay the premiums or in which the entity has a substantive obligation to provide the policyholder with services. A substantive obligation to provide services ends when:*

(a) *the entity has the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects those risks; or*

(b) *both of the following criteria are satisfied:*

(i) *the entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio; and*

(ii) *the pricing of the premiums for coverage up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date.*'

18 Paragraph 35 of IFRS 17 states:

'An entity shall not recognise as a liability or as an asset any amounts relating to expected premiums or expected claims outside the boundary of the insurance contract. Such amounts relate to future insurance contracts.'

What is the issue?

19 The submission asks whether insurance contracts with annual repricing mechanisms would have a contract boundary of one year or longer than one year because after one year, the cash flows would relate to future contracts.

20 The submission provides, in Appendix 1 of Paper 04-03, features of two insurance contracts – a 'step-rated insurance contract' and a 'participating contract'. The submission provides three alternative views[5] specific to these two insurance contract examples.

21 The submission notes that:

(a) for the 'step-rated insurance contract' the premium for a new 40-year-old policyholder would be the same as the premium for an existing 40-year-old policyholder, assuming that they are both in standard health when they buy the contracts and there are no loyalty discounts in place; and

(b) similar pricing mechanisms apply to the 'participating contract'.

IASB staff analysis

22 Since both contracts have a repricing mechanism at the portfolio level to reflect changes in the risks of the portfolio as a whole, the IASB staff based its analysis on paragraph 34(b) of IFRS 17 and, in particular, which risks are relevant in applying that paragraph.

23 The IASB staff believe that, consistent with the requirements in paragraph 34(a), when the IASB Board added the requirements in paragraph 34(b) of IFRS 17, the IASB Board had in mind the policyholder risks in the portfolio, rather than any wider risks to which the entity might be exposed or consider when pricing contracts.

24 Based on the features of the contracts described in the submission, the entity issuing a 'step-rated insurance contract' or a 'participating contract' can reset the premiums or the insurance fees of those contracts annually to reflect reassessed risks at a portfolio level.

25 The IASB staff believe that the underlying principle of the determination of the contract boundary is that a contract renewal with the same premium that would be available to a new policyholder should be treated as a new contract because the existing contract does not confer on the existing policyholder any further substantive rights.

26 Accordingly, the IASB staff conclude that, for the 'step-rated insurance contract', the cash flows resulting from renewal terms should not be included within the boundary of the existing insurance contract. Similar considerations apply to the 'participating contract'.

IASB paper AP03 - Boundary of reinsurance contracts held (Agenda paper 09-07)

IFRS 17 requirement

27 IFRS 17 paragraphs 33 and 34 are stated in paragraphs 16 and 17 above.

What is the issue

28 The submission asks how to read paragraph 34 of IFRS 17 regarding the boundary of an insurance contract with respect to reinsurance contracts held.

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[5] View 1 – Both contracts have contract boundary longer than one year;

View 2 – Both contracts have contract boundary only for one year; and

View 3 – The 'step-rated insurance contract' having a contract boundary only for one year while the 'participating contract' has a contract boundary longer than one year.

29 The submission notes three different factors that could impact the assessment of cash flows within the contract boundary for reinsurance contracts held:

(a) The ability of the reinsurer to exercise rights and have obligations;

(b) The right of the reinsurer to terminate coverage; and

(c) The right and obligations of the holder of the reinsurance contract (sometimes called cedant).

IASB staff analysis

30 For reinsurance contracts held, premiums are paid rather than received and services are received rather than provided.

31 The cash flows within the boundary of the reinsurance contract held arise from the substantive rights and obligations of the holder of the contact. The IASB staff's view is that the substantive right of the entity that holds the reinsurance contract is to receive services from the reinsurer. The substantive obligation is to pay amounts to the reinsurer.

32 A substantive right to receive services from the reinsurer ends when:

(a) the reinsurer has the practical ability to reassess the risks transferred to the reinsurer and can set a price or level of benefits for the contract to fully reflect the reassessed risk;

(b) the reinsurer has a substantive right to terminate the coverage.

33 As a result, the boundary of a reinsurance contract held could include cash flows from underlying contracts covered by the reinsurance contract that are expected to be issued in the future.

IASB paper AP04 - Insurance acquisition cash flows paid on an initially written contract (Agenda paper 09-08)

IFRS 17 requirement

34 Insurance acquisition cash flows paid before a group of insurance contracts is recognised are included in the determination of the contractual service margin ('CSM'). Applying paragraph 27 of IFRS 17, when the insurance acquisition cash flows of a group of insurance contracts are paid (or received) before the group of insurance contracts is recognised an entity recognises an asset or liability. The entity derecognises that asset or liability when the group of insurance contracts to which the cash flows are allocated is recognised.

35 In determining the insurance acquisition cash flows to be included in the measurement of a group of contracts, the following IFRS 17 requirements are relevant:

(a) the level of aggregation requirements to determine each group (IFRS 17 paragraphs 14 to 24); and

(b) the contract boundary requirements (IFRS 17 paragraphs 33 to 35).

What is the issue?

36 The submission questions how to account for insurance acquisition cash flows unconditionally paid for each initially written contract. The entity:

(a) expects renewals outside the contract boundary to occur; and

(b) has written new business with that expectation.

37 The submission includes an example in Paper 04-05 paragraph 11 whereby a commission of CU200 is paid to an agent for each initially written insurance contract. Among other aspects in the fact pattern, the commission is greater than the premiums in the initially written contract's boundary. The entity expects a substantial

number of renewals over a number of years. Those renewals are outside the initially written contract's boundary.

38 There are three views proposed by the submission on the treatment of the insurance acquisition cash flows:

(a) View A - The acquisition cash flows are considered in the measurement of the group to which the initially written contract belongs and not considered in the measurement of the future groups to which the renewed contracts will belong;

(b) View B - The acquisition cash flows are considered in both the measurement of the group to which the initially written contract belongs and the future groups to which the renewed contracts will belong;

(c) View C - The acquisition cash flows are considered in the measurement of the group to which the initially written contract belongs. This is similar to View A except that in applying the IFRS 17 level of aggregation requirements, the contracts renewed in the same annual period as initially written contracts are in the same group as those that are initially written.

IASB staff analysis

39 The IASB staff consider that View A reflects the IFRS 17 requirements to be applied to the example because [emphasis added]:

(a) the specified insurance acquisition cash flows are directly attributable to those initially written contracts as **they are paid as a result of the initially written contracts**;

(b) those specified insurance acquisition costs cannot be allocated to future groups recognised on renewal because the specified costs **are paid unconditionally** for each initially written contract;

(c) The specified initial contracts **cannot be in the same group** as the specified contracts that are renewed during the same annual period applying the level of aggregation requirements.

Initially written contracts are onerous contracts at initial recognition because the acquisition cash outflows are greater than the cash inflows included in the contract boundary. The renewed contracts would be in a different group as they would not be onerous at initial recognition.

IASB paper AP05 - Determining quantity of benefits for identifying coverage units (Agenda paper 09-09)

IFRS 17 requirement

40 Paragraph B119 of IFRS 17 states:

'An amount of the contractual service margin for a group of insurance contracts is recognised in profit or loss in each period to reflect the services provided under the group of insurance contracts in that period (see paragraphs 44(e), 45(e) and 66(e)). The amount is determined by:

(a) *identifying the coverage units in the group. The number of coverage units in a group is the quantity of coverage provided by the contracts in the group, determined by considering for each contract the quantity of the benefits provided under a contract and its expected coverage duration.*

(b) *allocating the contractual service margin at the end of the period (before recognising any amounts in profit or loss to reflect the services provided in the period) equally to each coverage unit provided in the current period and expected to be provided in the future.*

(c) *recognising in profit or loss the amount allocated to coverage units provided in the period.'*

41 Paragraph BC279(a) states:
'… The Board considered whether:

(a) *the contractual service margin should be allocated based on the pattern of expected cash flows or on the change in the risk adjustment for non-financial risk caused by the release of risk. However, the Board decided the pattern of expected cash flows and the release of the risk adjustment for non-financial risk are not relevant factors in determining the satisfaction of the performance obligation of the entity. They are already included in the measurement of the fulfilment cash flows and do not need to be considered in the allocation of the contractual service margin. Hence, the Board concluded that coverage units better reflect the provision of insurance coverage. …'*

What is the issue?

42 A submission was received about how to determine the coverage units of a group of insurance contracts, specifically, what the definition of 'quantity of benefits' is. The coverage units are used to determine the amount of contractual service margin to be recognised in profit or loss for the period.

43 The submission identifies different factors that might be included in determining the quantity of benefits arising from insurance coverage. Therefore, the IASB staff have grouped those factors as follows:

(a) variability across periods in the level of cover provided by the contracts in the group[6]; and

(b) likelihood of an insured event occurring:

(i) to the extent that likelihood affects the expected duration of a contract (e.g. expectations of lapses and cancellations); and

(ii) to the extent that likelihood affects the amount expected to be claimed in a period.

IASB staff analysis

44 The IASB staff analysis focuses on the implementation of coverage units for insurance contracts without investment components. The IASB staff will analyse issues relating to contracts with investment components for the next IFRS 17 TRG meeting.

45 The IASB staff think it is clear that expectations of lapses and cancellations of contracts should be included in the determination of coverage units.

46 Based on paragraph BC279(a) of the Basis for Conclusions, expectations of the amount to be claimed in a period are not relevant factors in the determination of the quantity of benefits. Rather the benefit provided under the contract is the entity standing ready to meet the contractual maximum cover.

47 The IASB staff's view is that different levels of cover across periods should be included in the determination of the quantity of benefits.

48 The IASB staff provided some examples as follows[7]:

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[6] For example, some products provide a constant level of cover over the life of the contract (e.g. a death benefit of CU1m over a fixed term) whereas under other contracts the level of cover varies across periods (e.g. the benefit to be provided for a valid claim varies over time).

[7] Note that there are additional examples in Appendix A of agenda paper 09-09.

	Example	IASB staff view is that the coverage units would reflect:
1	A contract provides cover for fire damage up to CU50m per year on a five-year construction project. The value of the property covered is expected to increase over the 5 years.	the constant maximum limit of CU50 only
2	A contract provides cover for 5 years for default losses on a mortgage, after recovering the value of the property on which the mortgage is secured. The balance of the mortgage will decline because of contractually scheduled payments and cannot be increased.	the declining balance of the mortgage, but not the expected value of the property
3	A contract provides health cover for 10 years for specified medical costs up to CU1m over the life of the contract, with the expected amount and expected number of claims increasing with age.	the limit of CU1m initially. The coverage units would be reassessed at each reporting date to reflect the reduction in the cover available because of claims already made.

49 Therefore, overall, the IASB staff concludes that the determination of coverage units of a group should:

(a) **reflect the likelihood of an insured event occurring to the extent they affect the expected duration** of contracts in the group; and

(b) in principle **reflect variability across periods** in the level of cover provided by the contracts in the group (to be consistent with the treatment of contracts that provide different levels of cover). The level of cover is the contractual maximum level of cover in each period, not the level of cover expected; but

(c) **not reflect the likelihood of an insured event occurring to the extent they affect the amount expected to be claimed** in a period.

[Emphasis added.]

50 On the variability across periods in the level of cover provided (paragraph 49(b) above), the IASB staff observes:

(a) if the determination of coverage units reflects different levels of cover across periods, the only information required for the determination is the level of cover provided in the current period and expected to be provided in the future. If the determination of coverage units does not reflect different levels of cover across periods, an entity would determine the coverage units based on the average benefits over the duration of the contract (i.e. based on service provided over the duration of the contract).

(b) if a group includes contracts with different levels of cover that vary in different ways over time, reflecting the change in levels of cover provided by the group across periods may be more complex than using a constant level of cover for each contract determined on initial recognition (for example an average level of cover).

(c) the interaction with investment components is likely to be more complex if the quantity of benefits reflects changing levels of cover than if it reflects a constant level of cover.

IASB paper AP06 - Insurance acquisition cash flows when using fair value transition (Agenda paper 09-10)

IFRS 17 requirement

51 Refer to paragraph 34 above.

52 Insurance revenue recognised in a period includes amounts related to insurance acquisition cash flows (paragraph B121(b) of IFRS 17). This is determined by allocating a portion of the premiums that relate to recovering those cash flows to each reporting period in a systematic way on the basis of the passage of time. The same amount is recognised as insurance service expenses (paragraph B125 of IFRS 17).

What is the issue?

53 The submission questions whether, when the fair value approach to transition is applied, insurance acquisition cash flows that occurred prior to the transition date are recognised as revenue and expense in the statement of financial performance for reporting periods subsequent to the transition date.

54 The submission includes two views:

(a) View 1: Applying the fair value approach to determine the CSM at the transition date implies that it is impracticable to determine the insurance acquisition cash flows that occurred prior to the transition date. Therefore, it is not necessary to identify and recognise these amounts.

(b) View 2[8]: It is necessary to estimate insurance acquisition cash flows related to existing contracts and to recognise the corresponding revenue and expense even if applying the fair value approach to determine the CSM at the transition date.

IASB staff analysis

55 The IASB staff mention that, in applying the fair value approach:

(a) the entity is not required and is not permitted to include in the measurement of the CSM any insurance acquisition cash flows occurring prior to the date of transition and therefore, they are not included in presentation of insurance revenue and expenses;

(b) IFRS 17 does not require and does not permit an implicit identification of insurance acquisition cash flows that have occurred in the past; and

(c) this provides the entity with a ‘fresh start’ approach to transition.

IASB paper AP07 - Reporting on other questions submitted (Agenda paper 09-11)

56 Submissions have been categorised as questions that:

(a) can be answered applying only the words in IFRS 17;

(b) do not meet the submission criteria; or

(c) are being considered through a process other than a TRG discussion (such as a proposed annual improvement).

Questions that can be answered applying only the words in IFRS 17

57 The topics include:

[8] This view was regarded, by the submission, to be burdensome and largely impracticable.

(a) Subsequent treatment of contracts acquired in their settlement period (S04[9]);

(b) Allocating the contractual service margin at the end of a period to coverage units (S09);

(c) Using consistent assumptions for the measurement of reinsurance contracts held and the underlying insurance contracts (S17);

(d) Grouping contracts using the modified retrospective approach to transition (S20);

(e) Premiums received applying the premium allocation approach (S23); and

(f) Variable fee approach when the return is shared based on amortised cost measurement of the underlying items (S26).

58 Note that the IASB staff will consider publishing educational materials on these topics in the future.

Questions that do not meet the submission criteria

59 The topics include:

(a) Presentation of groups of insurance contracts in the statement of financial position (S03);

(b) Classification of contracts acquired in a business combination (S10);

(c) Discount rates applied to the contractual service margin for contracts without direct participation features (S24); and

(d) Investment components (S25).

60 Note that the criteria for the TRG implementation questions:

(a) must be related to, or arise from, IFRS 17;

(b) may result in possible diversity in practice; and

(c) are expected to be pervasive, i.e. relevant to a wide group of stakeholders.

Questions that are being considered through a process other than a TRG discussion

61 The topics include:

(a) Business combinations on transition - classification date (S06); and

(b) Discount rate to be used to adjust the contractual service margin of reinsurance contracts held (S16).

Questions for EFRAG TEG

62 Does EFRAG TEG have any comments on the February TRG topics?

63 Based on the above TRG topics, does EFRAG TEG consider that there will be implications on the draft endorsement advice for IFRS 17? Please explain.

[9] Log number used by the IASB staff.