IFRS

STAFF PAPER

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Project	**Insurance Contracts**		
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Introduction

1. Since IFRS 17 *Insurance Contracts* was published in May 2017, the staff have engaged in activities to support implementation of the Standard. As a result of those activities, the staff have become aware of instances where the drafting of IFRS 17 does not achieve what the Board intended.

2. This paper proposes minor changes to IFRS 17 to reflect the Board's intentions, as part of its next *Annual Improvements to IFRS Standards Cycle*.[1] In this paper, and in Agenda Paper 2B, the staff consider each possible amendment separately. Agenda Paper 2 explains why the staff think it is appropriate on a collective basis to propose these amendments to IFRS 17.

Staff recommendations

3. The staff recommends the Board proposes the following amendments to IFRS 17 (and other Standards affected by consequential amendments made by IFRS 17) in the next *Annual Improvements to IFRS Standards Cycle*:

[1] The staff have also made some editorial corrections to IFRS 17 since its publication. See https://www.ifrs.org/issued-standards/editorial-corrections/#tab1

(a) amendment to the terminology in paragraph 27 of IFRS 17 to include insurance acquisition cash flows relating to insurance contracts in the group yet to be issued;

(b) amendment to the terminology in paragraph 28 of IFRS 17 to achieve the intended timing of recognition of contracts within a group;

(c) removal of potential double-counting of the risk-adjustment for non-financial risk in the insurance contracts reconciliation disclosures and revenue analyses;

(d) correction of the terminology in the sensitivity analysis disclosures;

(e) exclusion of business combinations under common control from the scope of the requirements for business combinations in IFRS 17;

(f) amendment to IFRS 3 *Business Combinations* so that the consequential amendment made by IFRS 17 on the classification of insurance contracts applies prospectively;

(g) amendments to IFRS 7 *Financial Instruments: Disclosures*, IFRS 9 *Financial Instruments* and IAS 32 *Financial Instruments: Presentation* to achieve the intended interaction between the scopes of these financial instruments standards and the scope of IFRS 17, particularly with respect to insurance contracts held; and

(h) addition of an explanation that in Example 9 of the Illustrative Examples on IFRS 17 the time value of the guarantee changes over time.

4. Proposed wording for the amendments are set out in Appendix A.

5. An additional proposed amendment within the annual improvements cycle, on the coverage period for insurance contracts with direct participation features, is discussed in Agenda Paper 2B.

Staff analysis

6. The annual improvements cycle is limited to changes that either clarify the wording in a Standard or correct relatively minor unintended consequences,

oversights or conflicts between existing requirements of Standards. The staff think all the proposed amendments discussed in this paper meet those criteria.

7. **Amendment to the terminology in paragraph 27 of IFRS 17 to include insurance acquisition cash flows relating to insurance contracts in the group yet to be issued**—the term ‘issued’ was included in paragraph 27 of IFRS 17 to identify insurance contracts issued (as opposed to reinsurance contracts held). It was not intended to exclude insurance acquisition cash flows relating to insurance contracts in the group yet to be issued—insurance acquisition cash flows will often occur before a contract is issued and excluding them from the requirements of this paragraph would largely negate its purpose. The proposed amendments correct any inadvertent consequences of the use of the term ‘issued’.

8. **Amendment to the terminology in paragraph 28 of IFRS 17 to achieve the intended timing of recognition of contracts within a group**—paragraph 28 of IFRS 17 sets out how to recognise a group when contracts in the group qualify for recognition over more than one reporting period. The paragraph refers to contracts issued by the end of the reporting period, when it should refer to contracts that meet the criteria for recognition set out in paragraph 25 of IFRS 17. A consequential amendment is also needed to paragraph 24 of IFRS 17.

9. **Removal of potential double-counting of the risk adjustment for non-financial risk in the insurance contracts reconciliation disclosures and revenue analyses**—paragraphs 104, B121 and B124 of IFRS 17 identify the risk adjustment for non-financial risk separately. However, some amount of the risk adjustment for non-financial risk could also be captured in other components described in those paragraphs. The proposed amendments remove that potential double-counting.

10. **Correction of the terminology in the sensitivity analysis disclosures**—paragraphs 128 and 129 of IFRS 17 inadvertently used the term ‘risk exposure’ when they should use ‘risk variable’. The proposed amendments correct the terminology.

11. **Exclusion of business combinations under common control from the scope of the requirements for business combinations in IFRS 17**—the wording of paragraphs 39 and B93–B95 of IFRS 17 does not explicitly exclude business

combinations under common control. The Board never intended to include such transactions in the scope of the requirements in IFRS 17—they are the subject of a separate Board project. The proposed amendments exclude such business combinations.

12. **Amendment to IFRS 3 *Business Combinations* so that the consequential amendment made by IFRS 17 on the classification of insurance contracts applies prospectively**—IFRS 17 amends IFRS 3 so that the assessment of whether contracts acquired in a business combination are insurance contracts is made on the basis of terms and conditions at the acquisition date, rather than at the inception of the contract as previously required by IFRS 3. As reflected in Agenda Paper 2C of the February 2017 Board meeting, this amendment was intended to apply to business combinations with an acquisition date after the date of initial application of IFRS 17. However, the words in the amendment made by IFRS 17 are not clear. The proposed amendments clarify the intended result.

13. **Amendments to IFRS 7, IFRS 9 and IAS 32 to achieve the intended interaction between the scopes of these financial instruments standards and the scope of IFRS 17, particularly with respect to insurance contracts held**—IFRS 17 amended the scope paragraphs of IFRS 7, IFRS 9 and IAS 32 to refer to IFRS 17 rather than IFRS 4 *Insurance Contracts*. In doing so IFRS 17 inadvertently changed the scopes of these financial instruments Standards, in particular the effect of the amendments was to remove the scope exception in these Standards for insurance contracts held. (The amendment in IFRS 17 excluded from the scope of the financial instrument Standards only insurance contracts in the scope of IFRS 17 rather than the broader population of insurance contracts as defined in IFRS 17.) The proposed amendments correct that inadvertent consequence.

14. **Addition of an explanation that in Example 9 of the Illustrative Examples on IFRS 17 the time value of the guarantee changes over time**—the facts set out in Example 9 do not allow a reader to derive the numbers used in the example because they do not specify the amount of the time value of the guarantee. The staff have received queries on why the numbers are as they are. The staff do not plan to provide the calculation of the numbers but think it would be helpful to

indicate what factors are included, even though readers cannot derive the numbers.

Questions for the Board
Does the Board agree with our recommendation to propose the above amendments in the next *Annual Improvements to IFRS Standards Cycle*? The staff will ask for the Board's agreement on each amendment separately.

Appendix A: drafts of proposed amendments

A: To avoid any unintended consequences of using the term 'issued' in paragraph 27 of IFRS 17

27 An entity shall recognise an asset or liability for any *insurance acquisition cash flows* relating to a group of ~~issued~~ insurance contracts issued or expected to be issued that the entity pays or receives before the group is recognised, unless it chooses to recognise them as expenses or income applying paragraph 59(a). An entity shall derecognise the asset or liability resulting from such insurance acquisition cash flows when the group of insurance contracts to which the cash flows are allocated is recognised (see paragraph 38(b)).

B: To reflect the intended timing of recognition of contracts in paragraph 28 of IFRS 17

24 An entity shall apply the recognition and measurement requirements of IFRS 17 to the groups of contracts ~~issued~~ determined by applying paragraphs 14–23. An entity shall establish the groups at initial recognition, and shall not reassess the composition of the groups subsequently, except as set out in paragraph 28. To measure a group of contracts, an entity may estimate the *fulfilment cash flows* at a higher level of aggregation than the group or portfolio, provided the entity is able to include the appropriate fulfilment cash flows in the measurement of the group, applying paragraphs 32(a), 40(a)(i) and 40(b), by allocating such estimates to groups of contracts.

28 In recognising a group of insurance contracts in a reporting period, an entity shall include only contracts that meet the criteria set out in paragraph 26(a)-(c) applied to each contract ~~issued by the end of the reporting period~~ and shall make estimates for the discount rates at the date of initial recognition (see paragraph B73) and the coverage units provided in the reporting period (see paragraph B119). An entity may ~~issue~~ include more contracts in the group after the end of a reporting period, subject to paragraphs 14-22. An entity shall add the contracts to the group in the reporting period in which the contracts meet the criteria set out in paragraph 26(a)-(c) applied to each contract ~~are issued~~. This may result in a change to the determination of the discount rates at the date of initial recognition applying paragraph B73. An entity shall apply the revised rates from the start of the reporting period in which the new contracts are added to the group.

C: To remove potential double-counting of risk-adjustment for non-financial risk in the insurance contracts reconciliation disclosures and revenue analyses

104 An entity shall separately disclose in the reconciliations required in paragraph 101 each of the following amounts related to insurance services, if applicable:

(a) changes that relate to future service, applying paragraphs B96–B118, showing separately:

(i) changes in estimates that adjust the contractual service margin;

(ii) changes in estimates that do not adjust the contractual service margin, ie losses on groups of onerous contracts and reversals of such losses; and

(iii) the effects of contracts initially recognised in the period.

(b) changes that relate to current service, ie:

(i) the amount of the contractual service margin recognised in profit or loss to reflect the transfer of services;

(ii) the change in the risk adjustment for non-financial risk that does not relate to future service or past service; and

(iii) *experience adjustments* (see paragraphs B97(c) and B113(a)), excluding amounts relating to the risk adjustment included in (ii).

(c) changes that relate to past service, ie changes in fulfilment cash flows relating to incurred claims (see paragraphs B97(b) and B113(a)).

B121 Paragraph 83 requires the amount of insurance revenue recognised in a period to depict the transfer of promised services at an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services. The total consideration for a group of contracts covers the following amounts:

(a) amounts related to the provision of services, comprising:

(i) insurance service expenses, excluding any amounts relating to the risk adjustment included in (ii) and any amounts allocated to the loss component of the liability for remaining coverage;

(ii) the risk adjustment for non-financial risk, excluding any amounts allocated to the loss component of the liability for remaining coverage; and

(iii) the contractual service margin.

(b) amounts related to insurance acquisition cash flows.

B124 Consequently, insurance revenue for the period can also be analysed as the total of the changes in the liability for remaining coverage in the period that relates to services for which the entity expects to receive consideration. Those changes are:

(a) insurance service expenses incurred in the period (measured at the amounts expected at the beginning of the period), excluding:

(i) amounts allocated to the loss component of the liability for remaining coverage applying paragraph 51(a);

(ii) repayments of investment components;

(iii) amounts that relate to transaction-based taxes collected on behalf of third parties (such as premium taxes, value added taxes and goods and services taxes) (see paragraph B65(i)); ~~and~~

(iv) insurance acquisition expenses (see paragraph B125); and

(v) the amount related to the risk adjustment (see (b)).

(b) the change in the risk adjustment for non-financial risk, excluding:

(i) changes included in insurance finance income or expenses applying paragraph 87;

(ii) changes that adjust the contractual service margin because they relate to future service applying paragraphs 44(c) and 45(c); and

(iii) amounts allocated to the loss component of the liability for remaining coverage applying paragraph 51(b).

(c) the amount of the contractual service margin recognised in profit or loss in the period, applying paragraphs 44(e) and 45(e).

D: To correct the terminology in the sensitivity analysis disclosure requirements

128 An entity shall disclose information about sensitivities to changes in risk ~~exposures~~ variables arising from contracts within the scope of IFRS 17. To comply with this requirement, an entity shall disclose:

(a) a sensitivity analysis that shows how profit or loss and equity would have been affected by changes in risk ~~exposures~~ variables that were reasonably possible at the end of the reporting period:

(i) for insurance risk—showing the effect for insurance contracts issued, before and after risk mitigation by reinsurance contracts held; and

(ii) for each type of market risk—in a way that explains the relationship between the sensitivities to changes in risk ~~exposures~~ variables arising from insurance contracts and those arising from financial assets held by the entity.

(b) the methods and assumptions used in preparing the sensitivity analysis; and

(c) changes from the previous period in the methods and assumptions used in preparing the sensitivity analysis, and the reasons for such changes.

129 If an entity prepares a sensitivity analysis that shows how amounts different from those specified in paragraph 128(a) are affected by changes in risk ~~exposures~~ variables and uses that sensitivity analysis to manage risks arising from contracts within the scope of IFRS 17, it may use that sensitivity analysis in place of the analysis specified in paragraph 128(a). The entity shall also disclose:

(a) an explanation of the method used in preparing such a sensitivity analysis and of the main parameters and assumptions underlying the information provided; and

(b) an explanation of the objective of the method used and of any limitations that may result in the information provided.

E: To exclude business combinations under common control from the scope of the requirements for business combinations in IFRS 17

39 For insurance contracts acquired in a transfer of insurance contracts or a business combination within the scope of IFRS 3, an entity shall apply paragraph 38 in accordance with paragraphs B93–B95.

Initial recognition of transfers of insurance contracts and business combinations within the scope of IFRS 3 (paragraph 39)

B93 When an entity acquires insurance contracts issued or reinsurance contracts held in a transfer of insurance contracts that do not form a business or in a business combination within the scope of IFRS 3, the entity shall apply paragraphs 14–24 to identify the groups of contracts acquired, as if it had entered into the contracts on the date of the transaction.

B94 An entity shall use the consideration received or paid for the contracts as a proxy for the premiums received. The consideration received or paid for the contracts excludes the consideration received or paid for any other assets and liabilities acquired in the same transaction. In a business combination within the scope of IFRS 3, the consideration received or paid is the fair value of the contracts at that date. In determining that fair value, an entity shall not apply paragraph 47 of IFRS 13 (relating to demand features).

B95 Unless the premium allocation approach for the liability for remaining coverage in paragraphs 55–59 applies, on initial recognition the contractual service margin is calculated applying paragraph 38 for acquired insurance contracts issued and paragraph 65 for acquired reinsurance contracts held using the consideration received or paid for the contracts as a proxy for the premiums received or paid at the date of initial recognition. If acquired insurance contracts issued are onerous, applying paragraph 47, the entity shall recognise the excess of the fulfilment cash flows over the consideration paid or received as part of goodwill or gain on a bargain purchase for contracts acquired in a business combination within the scope of IFRS 3 or as a loss in profit or loss for contracts acquired in a transfer. The entity shall establish a loss component of the liability for remaining coverage for that excess, and apply paragraphs 49–52 to allocate subsequent changes in fulfilment cash flows to that loss component.

F: To clarify that the consequential amendments to IFRS 3 made by IFRS 17 on the classification of insurance contracts apply prospectively

IFRS 3 Business Combinations[2]

Effective date

…

64N IFRS 17, issued in May 2017, amended paragraphs 17, 20, 21, 35 and B63, and after paragraph 31 added a heading and paragraph 31A. An entity shall apply ~~those~~ the amendments to paragraph 17 to business combinations with an acquisition date after the date of initial application of IFRS 17. An entity shall apply the other amendments when it applies IFRS 17.

[2] The same amendment needs to be made to IFRS 3 as amended by IFRS 16.

G: To prevent insurance contracts held being included in the scope of IFRS 7, IFRS 9 and IAS 32

IFRS 7 Financial Instruments: Disclosures

3 This IFRS shall be applied by all entities to all types of financial instruments, except:

(a) ……

(d) insurance contracts as defined in ~~within the scope of~~ IFRS 17 *Insurance Contracts* and investment contracts with discretionary participation features within the scope of IFRS 17. However, this IFRS applies to:

(i) derivatives that are embedded in contracts within the scope of IFRS 17, if IFRS 9 requires the entity to account for them separately; and

(ii) investment components that are separated from contracts within the scope of IFRS 17, if IFRS 17 requires such separation.

Moreover, an issuer shall apply this IFRS to *financial guarantee contracts* if the issuer applies IFRS 9 in recognising and measuring the contracts, but shall apply IFRS 17 if the issuer elects, in accordance with paragraph 7(e) of IFRS 17, to apply IFRS 17 in recognising and measuring them.

IFRS 9 Financial Instruments

2.1 This Standard shall be applied by all entities to all types of financial instruments except:

(a) …..

(e) rights and obligations arising under (i) an insurance contract ~~a contract within the scope of~~ as defined in IFRS 17 *Insurance Contracts*, other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract, or (ii) an investment contract with discretionary participation features within the scope of IFRS 17. However, this Standard applies to (i) a derivative that is embedded in a contract within the scope of IFRS 17, if the derivative is not itself a contract within the scope of IFRS 17; and (ii) an investment component that is separated from a contract within the scope of IFRS 17, if IFRS 17 requires such separation. Moreover, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts, the issuer may elect to apply either this Standard or IFRS 17 to such financial guarantee contracts (see paragraphs B2.5–B2.6). The issuer may make that election contract by contract, but the election for each contract is irrevocable.

IAS 32 Financial Instruments: Presentation

4 This Standard shall be applied by all entities to all types of financial instruments except:

(a) ……

(d) insurance contracts as defined in ~~within the scope of~~ IFRS 17 *Insurance Contracts* and investment contracts with discretionary participation features within the scope of IFRS 17. However, this Standard applies to:

- **(i)** **derivatives that are embedded in contracts within the scope of IFRS 17, if IFRS 9 requires the entity to account for them separately; and**
- **(ii)** **investment components that are separated from contracts within the scope of IFRS 17, if IFRS 17 requires such separation.**

Moreover, an issuer shall apply this Standard to financial guarantee contracts if the issuer applies IFRS 9 in recognising and measuring the contracts, but shall apply IFRS 17 if the issuer elects, in accordance with paragraph 7(e) of IFRS 17, to apply IFRS 17 in recognising and measuring them.

H: To explain that in Example 9 of the Illustrative Examples on IFRS 17 the time value of the guarantee changes over time

IE104 On initial recognition of the contracts, the entity:

- (a) expects that the fair value of the specified pool of assets will increase by 10 per cent a year;
- (b) determines the discount rate that reflects the characteristics of the nominal cash flows that do not vary based on returns on any underlying items is 6 per cent a year;
- (c) estimates the risk adjustment for non-financial risk to be CU25 and expects to recognise it in profit or loss in Years 1–3 as follows: CU12, CU8 and CU5;
- (d) estimates the time value of the guarantee inherent in providing a minimum death benefit;[3] and
- (d) expects that one insured person will die at the end of each year and claims will be settled immediately.

IE105 During the coverage period~~,~~ there are changes in the time value of the guarantee, and changes in the fair value returns on underlying items~~,~~ as follows:

- (a) in Year 1, the fair value of the specified pool of assets increased by 10 per cent, as expected on initial recognition;
- (b) in Year 2, the increase in fair value was lower than expected on initial recognition and equals 8 per cent; and
- (c) in Year 3, the increase in fair value goes back to the initially expected 10 per cent.

[3] There is no prescribed method for the calculation of the time value of a guarantee and a calculation of an amount separate from the rest of the fulfilment cash flows is not necessarily required.