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STAFF PAPER

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Project	**Amendments to IFRS 17 *Insurance Contracts***
Paper topic	Sweep issues

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Purpose

1. This paper discusses issues for the International Accounting Standards Board (Board) to consider before finalising the Exposure Draft of proposed amendments to IFRS 17 *Insurance Contracts* that:

   (a) are consequential to issues that the Board has previously discussed; and

   (b) have been identified through stakeholder feedback, Transition Resource Group for IFRS 17 (TRG) discussions or when drafting the Exposure Draft.

Summary of staff recommendations

2. The staff recommend the Board:

   (a) revise its tentative decision to establish in IFRS 17 that an investment-return service exists only when an insurance contract includes an investment component, to instead specify that an investment-return service exists in specified circumstances, sometimes without an investment component (paragraphs 4–14 of this paper);

   (b) amend paragraph 103 of IFRS 17 to clarify that, in the reconciliation from the opening to the closing balance of the insurance contract liabilities, an entity need not disclose refunds of premiums separately (paragraphs 15–18 of this paper); and

(c) amend paragraph B123(a) of IFRS 17 to clarify that changes resulting from cash flows of amounts lent to customers and waivers of amounts lent to customers are excluded from insurance revenue (paragraphs 19–20 of this paper).

3. The staff recommend the Board not amend IFRS 17 or the Basis for Conclusions on IFRS 17 regarding the considerations for mutual entities issuing insurance contracts (paragraphs 21–27 of this paper).

Staff analysis

A—Investment-return service

4. At its January 2019 meeting, the Board tentatively decided to amend IFRS 17 so that in the general model the contractual service margin is recognised in profit or loss on the basis of coverage units that are determined by considering both insurance coverage and investment-return service, if any. The Board also tentatively decided to establish that an investment-return service can exist only when an insurance contract includes an investment component.

5. Following discussions at the TRG meeting in April 2019 and subsequent questions from stakeholders, the staff have developed analysis that indicates that an investment-return service might be provided in insurance contracts that do not include an investment component. As a result, the staff think that an investment-return service might be provided in some insurance contracts during the period in which a policyholder has a right to withdraw amounts from the entity. By a right to withdraw amounts from the entity, the staff include policyholders' rights to a surrender value or premium refund on cancelling the policy and rights to transfer an amount to another insurance provider. A policyholder might have such a right without the insurance contract including an investment component.

6. Consider an example of a deferred annuity contract under which premiums are paid upfront. The premiums earn a return during the accumulation phase and the accumulated amount can be converted into an annuity at a fixed conversion rate at

a future date. The accumulation phase could be a substantial number of years. During the accumulation phase the policyholder has the right to transfer the accumulated amount to another annuity provider or to receive the accumulated amount if he dies. After conversion into an annuity, there is no period of guaranteed payments—ie if the policyholder dies after conversion but before the first annuity payment, he receives nothing.

7. In the paper for the January 2019 Board meeting,[1] the staff analysis indicated that such a contract does not include an investment component and so could not be regarded as providing an investment-return service.

8. Some stakeholders disagree with that analysis and think an entity can provide an investment-return service in the accumulation phase in such contracts. The staff analysis in this paper supports that view—although there is no investment component, the policyholder has a right during the accumulation phase to withdraw an amount from the entity that includes an investment return.[2]

9. The staff observe that a right for the policyholder to withdraw money exists in many insurance contracts. Consider, for example, a car insurance contract with a premium paid at the start of the coverage period when the policyholder is able to cancel during the coverage period and receive back a pro-rata portion of the premium.

10. The staff also observe such a right for the policyholder to withdraw money (or to transfer an amount to another party) seems to indicate the entity is providing an investment-return service in the deferred annuity contracts. However, the same right in a car insurance contract does not seem to indicate the entity is providing such a service.

11. One question the Board considered when it discussed investment-return service at its January 2019 meeting was whether it was possible to provide criteria for when

[1] Agenda Paper 2E *Recognition of the contractual service margin in profit or loss in the general model* for the January 2019 Board meeting.

[2] The analysis in paragraph 8 of this paper differs from that in Agenda Paper 1 *Investment components within an insurance contract* for the April 2019 TRG meeting. The analysis in that paper for the TRG meeting led to the same conclusion that an investment-return service might be provided by such contracts, but based that conclusion on the identification of an investment component in such a contract. The staff no longer support that identification of an investment component because the staff do not think it is possible to distinguish between policyholder's right in the deferred annuity contract described in paragraph 6 of this paper and the policyholder's right in the car insurance contract described in paragraph 9 of this paper.

such a service might exist, other than linking it to the existence of an investment component, for example that the promised return had to be a variable return rather than a fixed amount. The Board concluded that it would be difficult to identify criteria for when an investment-return service exists, or to develop an objective that is clear and applicable in all circumstances. Using the existence of an investment component as a necessary, albeit not sufficient, threshold was thought to be a reasonable approach while practice develops.

12. In contrast, the staff think that if the Board accepts that an investment-return service could exist when a policyholder has a right to withdraw money from the entity, even when an investment component does not exist, it would be necessary to provide some criteria for when such a service exists. As explained in paragraph 9 of this paper, there are many insurance contracts in which policyholders have such rights, not all of which provide investment-return service. This makes it more important to set some criteria for when an investment-return service exists.

13. The staff have therefore tried to identify features that characterise such a service. The staff think that IFRS 17 should specify that an investment-return service exists if, and only if:

    (a) there is an investment component, or the policyholder has a right to withdraw an amount;

    (b) the investment component or amount the policyholder has a right to withdraw is expected to include a positive investment return; and

    (c) the entity expects to perform investment activity to generate that positive investment return.

14. Accordingly, the staff recommend the Board revise its tentative decision to establish in IFRS 17 that an investment-return service exists only when an insurance contract includes an investment component, to instead specify that an investment-return service exists in specified circumstances, sometimes without an investment component.

B—Amendment to clarify that an entity need not separately disclose refunds of premiums

15. Paragraph 100 of IFRS 17 requires disclosure of a reconciliation from the opening to the closing balances of the insurance contract liability. Paragraph 103 of IFRS 17 requires an entity to separately disclose—in that reconciliation—investment components excluded from insurance revenue and insurance service expenses. The requirements in those paragraphs of IFRS 17 enable users of financial statements to analyse information about the insurance service result, including information about the determination of insurance revenue and the linkage between amounts in the statement of financial position and the statement of financial performance. Insurance revenue can be analysed as the total of the changes in the liability for remaining coverage in the period that relate to coverage or other services for which the entity expects to receive consideration.

16. TRG discussions highlighted different concerns arising from different types of insurance contracts:

    (a) TRG discussions indicated that some stakeholders wondered whether the possibility of the policyholder ceasing coverage during the coverage period and receiving a refund of premiums was an investment component. Hence, those stakeholders thought entities might have to exclude some amounts from claims when they occur. At its April 2019 meeting, the Board tentatively decided to amend IFRS 17 to clarify the definition of an investment component in Appendix A of IFRS 17, by stating that an investment component is the amounts that an insurance contract requires the entity to repay to a policyholder in all circumstances. This proposed amendment would resolve the confusion for these contracts.

    (b) for insurance contracts that include investment components, TRG discussions indicated concerns that the proposed amendment discussed in paragraph 16(a) of this paper requires an entity to separate the amount payable when a claim occurs into:

        (i) the amount that would have been paid if the policyholder cancelled the contract (a refund of premiums);

(ii) the amount that would have been paid if the policyholder did not cancel the contract or make a claim (an investment component); and

(iii) the remainder (the insurance service expense).

The staff observed that the amounts described in paragraph 16(b)(i) and (ii) of this paper are treated in the same way, except for the separate disclosure required for the investment component.

17. In the staff view, in the reconciliation required by paragraph 100 of IFRS 17, the information about the insurance service result discussed in paragraph 15 of this paper, including insurance revenue recognised in the period, would be obtained if an entity presented refunds of premiums separately or together with either:

(a) investment components (ie presentation of a single line reflecting the sum of investment components and refunds of premiums); or

(b) premiums received (ie presentation of a net amount of premiums received and premiums refunded).

18. Therefore, in the light of stakeholder feedback discussed in paragraph 16 of this paper, the staff recommend the Board amend paragraph 103 of IFRS 17 as set out below to clarify that, in the reconciliation from the opening to the closing balance of the insurance contract liability, an entity need not disclose refunds of premiums separately.

> 103 An entity shall separately disclose in the reconciliations required in paragraphs 100 each of the following amounts related to insurance services, if applicable:
>
> (a) […]
>
> (c) investment components (and refunds of premiums unless presented as part of the cash flows in the period) excluded from insurance revenue and insurance service expenses.

C—*Amendment to clarify that changes resulting from cash flows of amounts lent to policyholders and waivers of amounts lent to policyholders are excluded from insurance revenue*

19. Some contracts in the scope of IFRS 17 include a loan component—ie the entity lends amounts to the policyholder and expects the policyholder to repay the entity at a later date. The payment or receipt of amounts lent to and repaid by

policyholders should not give rise to insurance revenue. Paragraph B123 of IFRS 17 omits the exclusion of these amounts from the changes in the liability for remaining coverage that give rise to insurance revenue. Any waiver of a loan to a policyholder would be treated in the same way as any other claim.

20. The staff recommend the Board amend paragraph B123(a) of IFRS 17 as set out below to add this exclusion and therefore clarify that those amounts are excluded from insurance revenue.

> B123 Applying IFRS 15, when an entity provides services, it derecognises the performance obligation for those services and recognises revenue. Consistently, applying IFRS 17, when an entity provides services in a period, it reduces the liability for remaining coverage for the services provided and recognises insurance revenue. The reduction in the liability for remaining coverage that gives rise to insurance revenue excludes changes in the liability that do not relate to services expected to be covered by the consideration received by the entity. Those changes are:
>
> (a) changes that do not relate to services provided in the period, for example:
>
> (i) […]
>
> (iiA) changes that relate to loans to policyholders.

D—Mutual entities issuing insurance contracts

21. Paragraphs BC264–BC269 of the Basis for Conclusions on IFRS 17 refer to insurers that are mutual entities, in the context of explaining why the Board did not retain the 'mirroring approach' in the 2013 Exposure Draft Insurance Contracts only for mutual entities. In particular:

(a) paragraph BC265 of the Basis for Conclusions on IFRS 17 explains that a defining feature of an insurer that is a mutual entity is that the most residual interest of the entity is due to a policyholder and not a shareholder. Thus, the fulfilment cash flows of an insurer that is a mutual entity generally include the rights of policyholders to the whole of any surplus of assets over liabilities. This means that, for an insurer that is a mutual entity, there should, in principle, normally be no equity remaining and no net comprehensive income reported in any accounting period.

(b) paragraph BC266 of the Basis for Conclusions on IFRS 17 explains that accounting mismatches arise between the measurement of insurance contracts and the measurement of the other net assets of an insurer that is a mutual entity. This is because the measurement of insurance contracts for an insurer that is a mutual entity incorporates information about the fair value of the other assets and liabilities of the entity, some of which are not required to be measured at fair value when applying IFRS Standards.

(c) paragraph BC267 of the Basis for Conclusions on IFRS 17 explains that when insurance contract liabilities are measured in applying IFRS 17, insurers that are mutual entities might report liabilities greater than recognised assets in their financial statements, even though those entities are solvent for regulatory purposes and economically have no equity (rather than negative equity).

22. Some stakeholders are concerned that the explanations included in those paragraphs of the Basis for Conclusions on IFRS 17 and the educational materials developed by the staff do not adequately reflect the nature of some mutual entities and might be used as prescriptive guidance for mutual entities applying IFRS Standards while, in their view:

(a) including fact patterns that do not apply to all mutual entities; and

(b) using terminology that might have different interpretations in practice (for example, the concept of residual interest in a mutual entity).

23. To address their concerns, those stakeholders suggested the Board:

(a) clarify that the considerations in the Basis for Conclusions on IFRS 17 apply only to some mutual entities; and

(b) develop further considerations for the treatment of other types of mutual entities.

24. The staff think that it is clear that the Basis for Conclusions on IFRS 17:

(a) accompanies, but is not part of, IFRS 17;

(b) summarises the considerations of the Board in developing IFRS 17—ie it does not set out IFRS requirements; and

(c) does not define terms used in IFRS 17 (terms of IFRS 17 are defined only in Appendix A of IFRS 17 which does not include a definition of a mutual entity).

25. The staff therefore recommend the Board not amend IFRS 17 or the Basis for Conclusions on IFRS 17 to clarify that the considerations in the Basis for Conclusions apply only to some mutual entities.

26. The staff note that IFRS 17:

(a) applies to all insurance contracts (as defined in IFRS 17) throughout the duration of those contracts, regardless of the type of entity issuing the contracts; and

(b) does not include specific requirements by type of entity.

27. The staff recommend the Board not amend IFRS 17 to develop specific requirements for mutual entities for the reasons the Board previously decided not to do so—ie because:

(a) the requirements of IFRS 17 are consistent with the principles in IFRS 17 to include in the fulfilment cash flows all the future cash flows that arise within the boundary of insurance contracts in a group of contracts, regardless of the timing and counterparty;

(b) if a mutual entity that issues an insurance contract accounted for that contract in one way and a non-mutual entity that issues the same insurance contract accounted for that contract in a different way, comparability across entities would be reduced; and

(c) a robust definition of a mutual entity that could be applied consistently from jurisdiction to jurisdiction would be difficult to create.

Question for Board members

Do you agree with the staff recommendations for resolving the issues identified in this paper?