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IFRS 17
Potential Amendments

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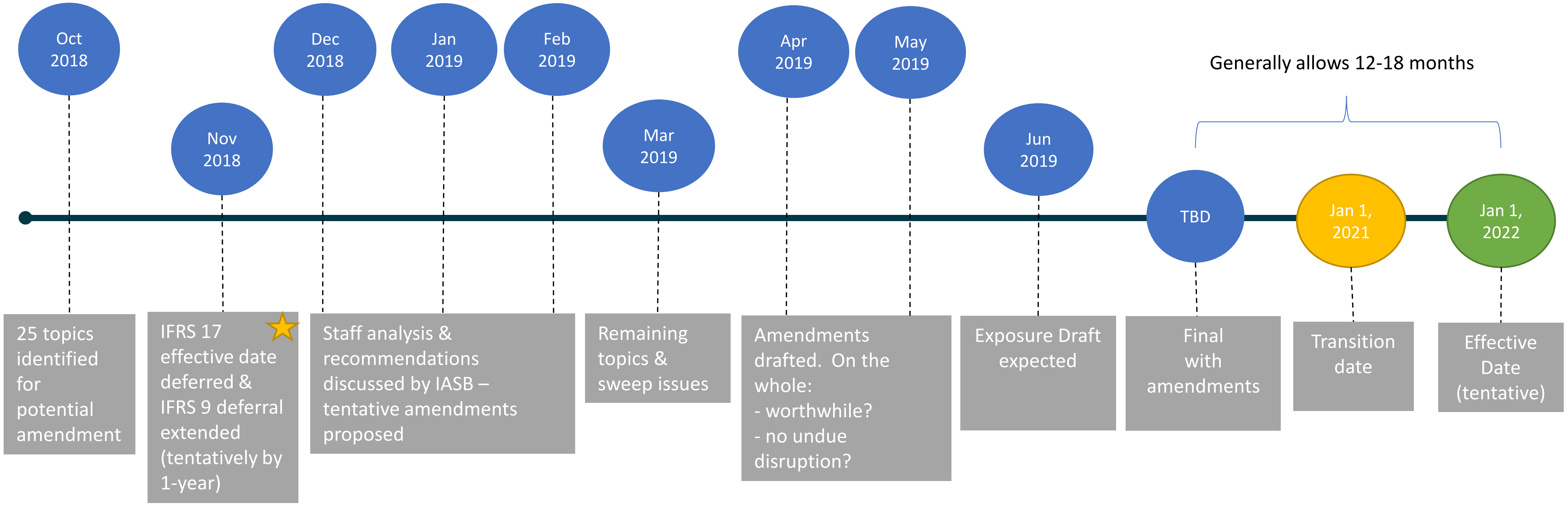
Update on IASB activities



IFRS 17 Potential Amendments

#1 – Loans and other forms of credit that transfer significant insurance risk

February 2019 2A; March 2019 2D; March 2019 2F

Description of issue:

- Scope of IFRS 17 includes contracts with "significant insurance risk" as defined by IFRS 17, even if that insurance risk is insignificant in relation to the rest of the contract
- Particular concern for non-insurers – under IFRS 4 they can choose to unbundle, but IFRS 17 prohibits separation of non-distinct components

Recommendation: **Amend**

- Allow portfolio-by-portfolio choice to apply IFRS 9 or IFRS 17 if the only insurance risk relates to the settlement of (policyholder) obligations created by the contract
  - Consequential amendments to transition requirements of IFRS 9 and IFRS 17
- Credit cards that provide insurance coverage will be excluded from scope of IFRS 17 if the entity does not assess customer's insurance risk in setting the price

Comments:

- IFRS 9/17 choice applies to waiver of premiums benefits on investment contracts

IFRS 17 Potential Amendments

#2 – Level of aggregation of insurance contracts

March 2019 2A,2B,2C

Description of issue:

- 2.1 - annual cohorts add cost, complexity for little value
- 2.2 – annual cohorts should not be required when risk is shared with policyholders over time
- 2.3 – requiring 3 profitability groups adds cost, complexity for little value

Recommendation: **Do not amend**

- IASB continues to believe that grouping provides meaningful information
- For 2.2, it is already clear that annual cohorts can be ignored if risk sharing would make them moot

Comments:

- Long-standing issue with actuaries, preparers

IFRS 17 Potential Amendments

#3 – Acquisition cash flows for renewals outside the contract boundary

January 2019 2A; March 2019 2G

Description of issue:

- If renewals are outside the contract boundary, recognizing all acquisition expenses (e.g., up-front commissions) at initial recognition would create an onerous initial contract with highly profitable renewals

Recommendation: Amend

- Require deferral of acquisition expenses allocated to renewals outside the contract boundary (future contracts)
- DAC asset requires recoverability testing; any remaining asset is included in initial measurement at renewal
- Additional disclosure requirements:
  - Reconciliation of DAC asset
  - Expected inclusion in related groups

Comments:

- Write-off of DAC is an impairment loss; different than if acquisition expense is incurred in the same period as the renewal (onerous contract with loss component)

IFRS 17 Potential Amendments

#4 – Use of locked-in rates to adjust the CSM

December 2018 2B

Description of issue:

- Using locked-in discount rates for CSM adjustments creates spurious volatility in investment results unless the OCI option is elected (“catch-up” interest adjustment from initial recognition)

Recommendation: **Do not amend**

- IASB could not accept the alternative to use locked-in rates where the OCI option is elected and current rates otherwise - removes volatility but the total liability would be different
- Using locked-in rates is consistent with the principles underlying the CSM

Comments:

- Not an issue for contracts with direct participation features (VFA)

IFRS 17 Potential Amendments

#5 – Subjectivity – Discount rates and risk adjustment

December 2018 2B

Description of issue:

- Subjectivity in discount rates and risk adjustment creates lack of comparability

Recommendation: **Do not amend**

- Overall objectives are principles-based vs. rules-based
- Need to rely on judgement in such a complex business
- IASB continues to believe IFRS 17 provides the right balance

Comments:

- Canadian actuarial profession is considering whether range of practice should be narrowed to allow GAAP statements to continue to be used for statutory purposes

IFRS 17 Potential Amendments

#6 – Risk adjustment in a group of entities

December 2018 2B

Description of issue:

- Unclear whether the RA for a group of contracts in a consolidated entity could be different than the RA for the same group in a subsidiary entity

Recommendation: **Do not amend**

- Allows for two possible interpretations:
  - Subsidiary view determines the RA, and consolidated entity accepts
  - Each entity determines the RA according to its own view

Comments:

- Disagreement in principle, but unlikely to be a concern in practice

IFRS 17 Potential Amendments

#7 – CSM | Coverage units in the general model

January 2019 2E; March 2019 2G

Description of issue:

- Amortization of CSM is restricted to insurance services (except for VFA)
- Creates strange pattern of P&L for insurance contracts that provide investment services but are not VFA

Recommendation: **Amend**

- Coverage units should consider both insurance services and “investment return service”
- Investment component is necessary but not sufficient indicator of “investment return service”
- Additional disclosure requirements:
  - Quantitative disclosure of expected CSM runoff (no option for qualitative)
  - Disclosure of approach to combining different coverages

Comments:

- (To be confirmed) providing a guaranteed CSV is not an “investment return service”, so coverage unit for life insurance is (FA – CSV) rather than FA

IFRS 17 Potential Amendments

#8 – CSM | Limited applicability of risk mitigation exception

December 2018 2C; January 2019 2D; February 2019 2C; March 2019 2E

Description of issue:

- 8.1 – Risk mitigation exception in VFA (B115) should not be limited to derivatives
- 8.2 – Risk mitigation exception should not be limited to VFA (only a problem if OCI)
- 8.3 – Risk mitigation exception should be applied when using a retrospective approach on transition

Recommendation: **Amend (8.1) | Do not amend (8.2) | Amend (8.3)**

- 8.1 – Expand to allow risk mitigation exception for reinsurance contracts held as well as derivatives
- 8.2 – Unclear whether the issue was clear
- 8.3 – OK in comparative year if can be done prospectively (without hindsight); Allow option to use fair value (even if full retro is practicable) on VFA portfolios where risk mitigation would have applied

Comments:

- 8.1 solves most, but not all issues with not allowing reinsurance contracts held to qualify for VFA (#13)

IFRS 17 Potential Amendments

#9 – PAA | Premiums received

December 2018 2A

Description of issue:

- The need to allocate premium cash flows and liability for incurred claims (LIC) to each group adds enormous cost for little benefit
- Cash management systems are not linked to valuation systems in many entities

Recommendation: **Do not amend**

- Issue is mitigated by amendment recommended in #15
- See related topic #16

Comments:

- Still some outstanding concerns (esp. P&C), but the most significant concerns have been addressed

IFRS 17 Potential Amendments

#10 – Business combinations | Classification of contracts

December 2018 2D

Description of issue:

- Acquisition of insurance contracts requires reclassification at acquisition date, so classification in acquired entity could be different than in acquiring entity
- Effected by removing exception in IFRS 3 (Business Combinations)

Recommendation: **Do not amend**

- IASB prefers consistent accounting for all contracts in a business combination

Comments:

- Acquisitions made prior to the effective date of IFRS 17 are grandfathered

IFRS 17 Potential Amendments

#11 – Business combinations | Contracts acquired during the settlement period

December 2018 2D; February 2019 2D

Description of issue:

- 11.1 – Insurance contracts acquired during settlement period (LIC) become LRC
  - Inappropriate gross-up of revenue and expense
  - Inconsistent accounting for written vs. acquired
  - Enormous expense for entities with only PAA
- 11.2 – Transition requirements could cause LIC to become LRC within an entity

Recommendation: **Do not amend (11.1) | Amend (11.2)**

- 11.1 – IASB continues to believe IFRS 17 takes the right approach
- 11.2 – Amend transition requirements to require (modified retro) or allow (fair value) LIC to stay LIC

Comments:

- 11.1 is a long-standing concern for P&C entities

IFRS 17 Potential Amendments

#12 – Reinsurance | Initial recognition when underlying contracts are onerous

January 2019 2B,2C

Description of issue:

- Initial loss on direct is immediately recognized, but corresponding gain on reinsurance contract held is deferred

Recommendation: **Amend**

- Adjustment to CSM of reinsurance contract held to offset proportionate share of loss on underlying direct
- Limited to “proportionate” reinsurance - not clear what is included (though stop loss clearly isn’t)

Comments:

- Basing adjustment on proportionate share of loss on underlying direct is simple and generous
  - No need to prove there is a gain on reinsurance contract held
  - No need to identify causes of onerous loss and attribute to reinsurance
- Restriction to proportionate is quid pro quo

IFRS 17 Potential Amendments

#13 – Reinsurance | Ineligibility for the variable fee approach

January 2019 2D

Description of issue:

- Reinsurance contracts (issued or held) are ineligible for VFA

Recommendation: **Do not amend**

- IASB continues to believe IFRS 17 is appropriate
- Most concerns were mitigated via amendment in #8

Comments:

- Concern remains for:
  - Reinsurance contracts issued that meet the requirements (unusual)
  - Non-financial risk sharing in reinsurance contracts held (risk mitigation option only covers financial risk)

IFRS 17 Potential Amendments

#14 – Reinsurance | Cash flows from underlying direct contracts not yet issued

December 2018 2E

Description of issue:

- Measurement of reinsurance contracts held might include expected cash flows related to underlying direct contracts that are not yet issued

Recommendation: **Do not amend**

- Consistent with the general principle that reinsurance contracts held are accounted for as separate contracts

Comments:

- Concerns largely mitigated by example in AP5 from September TRG meeting
  - If notice period for obligations to cede/assume new cessions coincides with the reporting period (e.g, 90 days), then no projection of future cessions is required
  - Related to IASB staff interpretation of B64

IFRS 17 Potential Amendments

#15 – Separate presentation of groups of assets and groups of liabilities

December 2018 2A

Description of issue:

- Significant practical concern when combined with #9
- Conceptually flawed to think of negative insurance contract liabilities as “assets”

Recommendation: **Amend**

- Require separate presentation of portfolios of assets and portfolios of liabilities
- Begrudging – IASB sees this as a deviation from principles for practical reasons

Comments:

- Measurement still requires group-by-group allocation for items that affect the CSM, but this amendment is a big help for (e.g.,) LIC
- Remaining concern that IASB doesn’t recognize that negative liabilities are not assets
- Some confusion between onerous/non-onerous versus liabilities/assets

IFRS 17 Potential Amendments

#16 – Presentation of premiums receivable

December 2018 2A

Description of issue:

- Premiums receivable should continue to be measured under IFRS 9 and reported separately, with IFRS 17 measurement using premiums due rather than premiums received

Recommendation: **Do not amend**

- Premium receivable is directly attributable to the contract
- Premium receivable balance can be presented separately if entity believes it provides useful information (e.g., about exposure to credit risk)

Comments:

- Long-standing concern for P&C entities
- Practical concerns are mitigated by amendment #15

IFRS 17 Potential Amendments

#17 – OCI option for insurance finance income/expense

December 2018 2B

Description of issue:

- Allowing the OCI option leads to lack of comparability and potential for earnings manipulation

Recommendation: **Do not amend**

- The OCI option was developed to alleviate concerns with mark-to-market volatility
- Required disclosures mitigate concerns about comparability
- Removing the option now would be unduly disruptive to implementation plans of entities intending to use it

Comments:

- IASB has said that the structure of the OCI option should mean that entities within a jurisdiction are likely to make similar choices, which should mitigate concerns about comparability

IFRS 17 Potential Amendments

#18 – Insurance contracts with direct participation features | Scope of VFA

December 2018 2C

Description of issue:

- VFA approach should be permitted on more contracts with investment features (it dampens volatility of investment results); definition creates a "cliff" where similar contracts are accounted for differently

Recommendation: **Do not amend**

- There will be a "cliff" no matter where they draw the line
- The IASB continues to believe the line is in the best place

Comments:

- References to "asset management services" in December 2018 2C might appear to narrow the scope of VFA, but the scope as described in IFRS 17 will not be amended
- Continued uncertainty about whether participating insurance contracts in Canada are eligible for VFA

IFRS 17 Potential Amendments

#19 – Interim financial statements | Treatment of accounting estimates

December 2018 2F

Description of issue:

- Because reporting frequency affects the CSM, subsidiaries and parents with a different reporting frequencies could report different liabilities for the same groups of contracts

Recommendation: **Do not amend**

- IASB Staff are concerned that an amendment would add complexity and reduce comparability

Comments:

- Work with auditors to find a sensible solution

IFRS 17 Potential Amendments

#20 – Date of initial application of IFRS 17

November 2018 AP2

Description of issue:

- 2021 effective date is not realistically achievable

Recommendation: **Amend**

- IASB needs time to consider amendments; one year deferral is enough if they are disciplined
- Not because preparers have expressed need for more time

Comments:

- IASB is on track
- European endorsement also on track
- Many preparers still want another year

IFRS 17 Potential Amendments

#21 – Comparative information on transition

February 2019 2B

Description of issue:

- Need for comparative information means entities need to be ready a year before the effective date

Recommendation: **Do not amend**

- IASB thinks comparative information will be useful
- One year delay (#20) provides relief

Comments:

- If adopted at the same time, IFRS 9 comparatives will be needed to make IFRS 17 comparatives meaningful
  - Be prepared to avoid hindsight

IFRS 17 Potential Amendments

#22 – Temporary exemption from applying IFRS 9

November 2018 AP2

Description of issue:

- Temporary exemption from applying IFRS 9 should be extended to coincide with the new effective date

Recommendation: **Amend**

- IASB sees the benefit of applying IFRS 9 and IFRS 17 together (would be confusing to users to apply IFRS 9 before IFRS 17 and then re-classify assets when IFRS 17 is adopted)

Comments:

- IASB thinks IFRS 9 is overdue and some voted against this amendment. Though it passed, it is highly unlikely that they would delay again, even if IFRS 17 were delayed another year.

IFRS 17 Potential Amendments

#23 – Transition | Optionality

February 2019 2B

Description of issue:

- Optionality of transition approach reduces comparability

Recommendation: **Do not amend**

- IASB has a clear preference for full retrospective, so there is no desire to (a) remove the modified retrospective option or (b) require fair value always (even if full retro is impracticable)
- Some would prefer to only allow fair value if modified retrospective can't be applied, but that could unduly disrupt implementation for those planning to use fair value
- Disclosure requirements mitigate comparability concerns

Comments:

- Demonstrating "impracticability" of full retrospective approach continues to be a concern

IFRS 17 Potential Amendments

#24 – Transition | Modified retrospective approach

February 2019 2D

Description of issue:

- Modified retrospective approach is too restrictive

Recommendation: **Do not amend (other than #11 and #8)**

- Allowing more modifications than necessary would reduce comparability and move further away from objective of getting as close to full retrospective as possible

Comments:

- Could encourage fair value, which seems to work against their objectives
- Annual cohorts are required if the issue date of contracts is available

IFRS 17 Potential Amendments

#25 – Transition | Accumulated OCI

February 2019 2C

Description of issue:

- Option to set accumulated OCI to nil when using the fair value option reduces comparability and distorts results

Recommendation: **Do not amend**

- Rejected alternative of setting accumulated OCI on liabilities to the corresponding OCI on assets (as in VFA), because assets are not well-defined (except in VFA)

Comments:

- Flexibility is appreciated