This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

Interaction of IFRS 17 with IFRS 15
Issues Paper

Objective

1 The objective of this paper is to highlight the interaction of IFRS 17 *Insurance Contracts* with IFRS 15 *Revenue from Contracts with Customers.*

Information for EFRAG TEG

2 The EFRAG Secretariat noted that the *European Parliament resolution of 3 October 2018 on International Financial Reporting Standards: IFRS 17 Insurance Contracts (2018/2689(RSP))* paragraph 10 states the following with regards to IFRS 15:

‘*IFRS 17 notes that exemptions to IFRS 17 and IFRS 9 that allow for the application of IFRS 15 to relevant contracts; calls on the EFRAG to assess whether this treatment is appropriate*’.

3 The EFRAG Secretariat noted that the following questions were also raised:

(a) Assess whether the boundary in applying IFRS 15 and 17 is appropriate; and

(b) Assess the boundary of IFRS 17 and 15 in a financial group.

4 It was also noted that there are other areas where there are interactions between IFRS 17 and IFRS 15 such as:

(a) Separating components from an insurance contract;

(b) Unit of account; and

(c) Insurance acquisition cash flows.

However, taking the request in paragraph 2 - 3 into consideration these topics have not been considered in this paper. They have been provided for background purposes only.

5 In the appendix, this paper distinguishes between:

(a) Proposed text for topics that will be included in the draft endorsement advice; and

(b) Topics that will not be included in the draft endorsement advice.

Questions for EFRAG TEG

6 Does EFRAG TEG agree with the EFRAG Secretariat’s conclusion that the topics in paragraph 4 should not be within the scope of the paper? If not, which other topics should be included?

Appendix 1: Proposed text for the Draft Endorsement Advice

Introduction

1 This appendix includes the proposed text for topics that will either be included and those that will not be included in the draft endorsement advice.

Proposed text for topics that will be included in the draft endorsement advice

Fixed fee service contracts

2 Some contracts meet the definition of an insurance contract but have as their primary purpose the provision of services for a fixed fee. An entity (including insurers) may choose to apply IFRS 15 instead of IFRS 17 to such contracts that it issues if, and only if, specified conditions are met. The insurer may make that choice contract by contract, but the choice for each contract is irrevocable. The conditions are:

(a) the insurer does not reflect an assessment of the risk associated with an individual customer in setting the price of the contract with that customer;

(b) the contract compensates the customer by providing services, rather than by making cash payments to the customer; and

(c) the insurance risk transferred by the contract arises primarily from the customer’s use of services rather than from uncertainty over the cost of those services.

3 EFRAG notes that there are differences between IFRS 17 and IFRS 15, such as the separation of receivables when applying IFRS 15, the recognition of onerous contracts, and the aggregation or portfolio requirements.

4 EFRAG notes that entities would have been required to apply IFRS 15 to fixed-fee service contracts. However, it has been acknowledged that if IFRS 17 were to apply, entities would generally apply the premium allocation approach to such contracts, which would result in accounting similar to that which would result from applying IFRS 15.

5 EFRAG assesses that the option to apply IFRS 15 will be made by those entities that do not operate the insurance business, but that due to the specific contractual and pricing terms of a contract that regulate primarily a service obligation, enter into contracts that meet the definition of insurance contract of IFRS 17. For these entities the practice of accounting for these contracts in the same way as other contracts with customers would provide useful information for the users of financial statements for the entities that issue such contracts. Hence, EFRAG assesses that applying IFRS 17 to these contracts would impose costs for no significant benefit.

6 EFRAG also notes that the option to apply IFRS 17 for fixed-fee service contracts allows insurers to simplify operationally the accounting process, extending IFRS 17 accounting to these contracts, contributing to the positive interaction of applying the two Standards together.

Assessing whether the boundary in applying IFRS 15 and 17 is appropriate

7 EFRAG notes that the fixed-fee scope exclusion is limited to contracts whose primary purpose is the provision of services for a fixed fee. However, it is noted that some entities issue both fixed-fee service contracts and other insurance contracts. For example, some entities issue both roadside assistance contracts and insurance contracts for damage arising from accidents. EFRAG assesses that the choice to allow entities either to apply IFRS 17 or IFRS 15 to fixed-fee service contracts would enable such entities to account for both types of contract in the same way.

Assessing the boundary of IFRS 17 and 15 in a financial group

8 EFRAG notes that under IFRS 17, consistent with IFRS 15, an insurer depicts revenue for the transfer of promised coverage and other services at an amount that reflects the consideration to which the insurer expects to be entitled in exchange for the services. This means that the insurer:

(a) excludes from insurance revenue any investment components; and

(b) recognises insurance revenue in each period as it satisfies the performance obligations in the insurance contracts.

9 EFRAG also acknowledges that, depending on the measurement model under IFRS 17, the accretion of interest is accounted for differently. However, such interest is not within the scope of IFRS 15.

Questions for EFRAG TEG

10 Does EFRAG TEG have comments on the analysis?

11 Does EFRAG TEG agree with the proposed text to be included in the draft endorsement advice?

Topics that will not be included in the draft endorsement advice

12 Please note that these topics were previously discussed with EFRAG TEG and EFRAG Board and for completeness we have included them here. However, these topics will not be included within the draft endorsement advice.

Separating components from an insurance contract

13 Under IFRS 17 an insurer should separate performance obligations to provide goods and non-insurance services from the host contract, regardless of whether the host contract is within the scope of IFRS 17 or of IFRS 15. Accordingly, IFRS 17 requires entities to separate only the goods and services that are distinct from the provision of insurance coverage, in a consistent manner to IFRS 15. IFRS 17 requires an insurer to allocate the cash inflows of an insurance contract between the host insurance contract and the distinct good or non-insurance service, based on the stand-alone selling price of the components, consistent with IFRS 15.

Evidence from case studies

14 In the extensive case study, no evidence of separation of goods and services under current practice were noted.

15 Respondents to the simplified case study noted that unbundling were generally not used today, and no change is expected under IFRS 17.

EFRAG Secretariat analysis

16 Based on the result of the case studies the separation of components did not appear to be significant in the past and there is no evidence that that will change in nature.

Unit of account

17 For recognition and measurement requirements (including release of CSM), the unit of account is a group, but IFRS 17 allows that estimation of fulfilment cash flows can be done at a higher level of aggregation than a group or a portfolio. A group of insurance contracts may comprise a single contract.

18 IFRS 15 specifies the accounting of an individual contract with a customer as the unit of account, as a practical expedient an insurer may apply IFRS 15 to a portfolio of contracts (or performance obligations) with similar characteristics if the insurer reasonably expects that the effects on the financial statements of applying IFRS 15 to the portfolio would not differ materially from applying IFRS 15 to the individual

contracts (or performance obligations) within that portfolio. When accounting for a portfolio, an insurer shall use estimates and assumptions that reflect the size and composition of the portfolio.

EFRAG Secretariat analysis

19 Although the EFRAG Secretariat did not ask for evidence on the impact of the unit of account between the two Standards, the EFRAG Secretariat notes that, in some cases, the unit of account under both IFRS 15 and IFRS 17 is the same.

Insurance acquisition cash flows

20 The EFRAG Secretariat notes the following in respect of acquisition costs:

(a) The scope and definition of acquisition costs under the two Standards differ, with IFRS 17 including a wider range of costs compared to IFRS 15;

(b) Similar to IFRS 15 costs can be capitalised and are subject to amortisation on a systematic basis over a period that can include expected renewals; and

(c) Under both Standards an entity would recognise an impairment loss in profit or loss and reduce the carrying amount of an asset for insurance acquisition cash flows so that it does not exceed the expected net cash inflow for the related group.

Evidence from case studies[1]

21 The evidence obtained from the extensive case study included the following:

(a) A respondent illustrated the impact of the treatment of acquisition costs on a property and casualty portfolio and noted that the pricing reflects expected renewals.

(b) Another respondent described the situation for property and casualty business where acquisition costs are unconditionally paid, i.e. without any claw-back clause if the contract is not renewed after the first year. The respondent notes there are strong historical records of persistence of the contracts (i.e. many of the policyholders continue the contract beyond the first year). Hence, the respondent argues that the economic duration of the contracts is longer than the contract boundary as defined in IFRS 17. This respondent quantified the difference between assigning the acquisition costs to new clients only, or to new clients and renewals. The respondent found that attributing acquisition costs to new clients only can lead to more onerous contracts. Further, this respondent noted that renewals can indirectly impact pricing as profitability assumptions are based on the expectation that contracts will be renewed over several years.

This respondent provided the following effect of IFRS 17 for its portfolio:

Acquisition costs allocated to	**A. New clients only**	**B. Renewals only**	**A+B New business (new clients and renewals together)**
Pre-tax profit	-21,4 mio Euro	+50.0 mio Euro	+29.8 mio Euro

The respondent explained that when acquisition costs are allocated to the new business in their entirety (new clients and renewals together), the portfolio is overall profitable. However, when the acquisition costs are allocated between new clients and renewals, the allocation to new clients makes their contracts onerous. Also, what can be drawn from this example is that the major part of

[1] The EFRAG Secretariat notes that the evidence from the case study was obtained before the amendment to IFRS 17, therefore it is outdated. Consequently, this topic has been evaluated as part of updating the case study.

the acquisition costs is attributed to renewals of the contracts from a commercial perspective.

22 In the simplified case study:

(a) Some respondents indicated that should the attribution of insurance acquisition costs only be assigned to new clients it does not reflect either the long-term business model of insurers or the economic reality of transactions as this requirement would likely result in onerous contracts. They stated that there are high acquisition costs relating to the first premiums payment, however, they expect that the business will renew thereby recuperating the initial acquisition costs.

(b) A respondent stated that if insurance acquisition cash flows are included as part of CSM, due to the CSM being released over a very long period of time for the annuity business, IFRS 17 would cause a significant mismatch between the expenses being incurred and the CSM being released to pay for those expenses. Another respondent indicated that since this requirement would lead to onerous contracts, this respondent would expect some changes in products and product trends.

EFRAG Secretariat analysis

23 The EFRAG Secretariat acknowledges that subsequent to the execution of the case studies, IFRS 17 have been amended to address the concerns raised by case study participants. Therefore, the topic has been reviewed as part of updating the case study.

Question for EFRAG TEG

24 Does EFRAG TEG have comments on the analysis?