IFRS

STAFF PAPER

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

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Purpose of the paper

1. In March 2020, the International Accounting Standards Board (Board) gave permission to begin the balloting process for finalising the amendments to IFRS 17 *Insurance Contracts*. This paper includes staff analysis and questions for Board members on sweep issues identified during the balloting process.

Summary of staff recommendations

2. The staff recommend the Board amend IFRS 17 to:

   (a) require an entity to include in the initial measurement of the contractual service margin of a group of insurance contracts the effect of the derecognition of any asset or liability previously recognised for cash flows related to that group paid or received before the group is recognised;

   (b) require an entity, in the circumstances described in paragraph 14 of this paper, to use a systematic and rational method of allocation to apply the requirements in IFRS 17 relating to the recovery of losses from reinsurance contracts held, as described in paragraph 16 of this paper;

(c) require an entity to recognise insurance revenue when the entity recognises in profit or loss amounts related to income tax that are specifically chargeable to the policyholder under the terms of an insurance contract; and

(d) include in the definitions of the liability for remaining coverage and the liability for incurred claims all obligations arising from insurance contracts issued by an entity.

3. The staff also recommend the Board amend the other comprehensive income (OCI) option and the risk mitigation option in IFRS 17 to:

(a) specify that paragraphs 88 and 89 of IFRS 17 do not apply to the insurance finance income or expenses that arise from the application of the risk mitigation option; and

(b) add new requirements to the risk mitigation option that specify how to present insurance finance income or expenses that arise from the application of the risk mitigation option, as described in paragraph 37 of this paper.

Structure of the paper

4. This paper discusses the following topics for which sweep issues have been identified during the balloting process:

(a) pre-recognition cash flows other than insurance acquisition cash flows (see paragraphs 7–11 of this paper);

(b) reinsurance contracts held—identifying losses on underlying insurance contracts (see paragraphs 12–18 of this paper);

(c) insurance revenue—income tax (see paragraphs 19–24 of this paper);

(d) definitions of the liability for remaining coverage and the liability for incurred claims (see paragraphs 25–29 of this paper); and

(e) variable fee approach—applying together the OCI option and the risk mitigation option (see paragraphs 30–38 of this paper).

5. For each topic, this paper provides:

   (a) a description of the sweep issue identified; and

   (b) staff analysis, recommendations and questions for Board members.

6. Appendix A to this paper sets out recommended drafting for the staff recommendations in this paper.

A—Pre-recognition cash flows other than insurance acquisition cash flows

Sweep issue

7. IFRS 17 has specific requirements for insurance acquisition cash flows that are paid before a group of insurance contracts is recognised—an entity recognises those cash flows as an asset, which the entity derecognises when it recognises the group of insurance contracts thereby adjusting the contractual service margin on initial recognition of the group.

8. The staff note there could be other cash flows related to a group of insurance contracts that are paid or received before the group is recognised—for example, premiums paid in advance of their due date. IFRS 17 is silent on the accounting for those other cash flows. In particular, paragraph 38 of IFRS 17 does not allow for their inclusion in the calculation of the contractual service margin on initial recognition.

Staff analysis and recommendation

9. The staff note that cash flows related to a group of insurance contracts that are paid or received before the group is recognised other than insurance acquisition cash flows:

   (a) are allowed for in the recognition and measurement requirements of IFRS 17 for groups of reinsurance contracts held.[1]

   (b) were included in the recognition and measurement proposals for insurance contracts issued in the 2013 Exposure Draft *Insurance Contracts*. Between the 2013 Exposure Draft and the issuance of IFRS 17, the pre-recognition cash

[1] Paragraph 65(b) of IFRS 17 requires the contractual service margin on initial recognition of a group of reinsurance contracts held to include the effect of the derecognition of any asset or liability previously recognised for cash flows related to that group.

flows for insurance contracts inadvertently became restricted to insurance acquisition cash flows.

10. Therefore, the staff recommend the Board amend IFRS 17 to require an entity to include in the initial measurement of the contractual service margin of a group of insurance contracts the effect of the derecognition of any asset or liability previously recognised for cash flows related to that group. Related cash flows are cash flows that would be included in the fulfilment cash flows of the group on initial recognition if they were paid after initial recognition rather than before. The staff note that adding this requirement should not disrupt implementation. The feedback on this point is that entities are expecting to do this, but are concerned that the requirement in paragraph 38 of IFRS 17 does not allow it.

11. Appendix A to this paper sets out recommended drafting for that recommended amendment (including a consequential amendment to paragraph 79 of IFRS 17).

Question 1 for Board members
Do you agree that the Board should amend IFRS 17 to require an entity to include in the initial measurement of the contractual service margin of a group of insurance contracts the effect of the derecognition of any asset or liability previously recognised for cash flows related to that group paid or received before the group is recognised?

B—Reinsurance contracts held—identifying losses on underlying insurance contracts

Sweep issue

12. The Board is amending IFRS 17 to require an entity to recognise in profit or loss recovery of losses from reinsurance contracts held when losses are recognised on initial recognition of onerous insurance contracts that are covered by the reinsurance contract held (underlying insurance contracts). IFRS 17 already includes a similar requirement when underlying insurance contracts become onerous subsequently (or become more or less onerous subsequently).

13. To determine the amount of recovery of losses from reinsurance contracts held, an entity needs to identify losses on the underlying insurance contracts.[2]

14. When grouping insurance contracts issued, an entity might group together:

    (a) onerous insurance contracts that are covered by (ie that are underlying) the reinsurance contract held; and

    (b) other onerous insurance contracts, which are not covered by the reinsurance contract held.

15. IFRS 17 does not require an entity to identify or subsequently track the amount of losses on onerous contracts at a level that is lower than the group level. Therefore, if an entity groups together onerous underlying insurance contracts and other onerous insurance contracts as described in paragraph 14 of this paper, the entity might not have the information available to identify the amount of losses on underlying insurance contracts for the purpose of determining the amount of recovery of losses from reinsurance contracts held.

Staff analysis and recommendation

16. The staff think that it would be unduly burdensome to require an entity to identify and track the amount of losses on onerous insurance contracts at a level lower than the group level to determine the amount of recovery of losses from reinsurance contracts held. Therefore, in the circumstances described in paragraph 14 of this paper, the staff think it would be helpful to specify that an entity should use a systematic and rational method of allocation to determine the portion of losses recognised on the group of insurance contracts that relates to the underlying insurance contracts in the group (ie the insurance contracts covered by the reinsurance contract). An entity would use the same systematic and rational method of allocation to determine the portion of subsequent changes in the loss component of the group of insurance contracts that relates to underlying insurance contracts in the group.

17. Requiring an allocation applying a systematic and rational method would be consistent with other requirements in IFRS 17. Specifying such an allocation would

[2] If an entity is determining the loss-recovery component of a reinsurance contract held at the date of transition to IFRS 17 or at the date of acquisition of a contract, the entity needs to identify the loss component of underlying insurance contracts.

also help entities to apply the requirements relating to the recovery of losses from reinsurance contracts held.

18. Therefore, the staff recommend the Board amend IFRS 17 as described in paragraph 16 of this paper. Appendix A to this paper sets out recommended drafting for that recommended amendment.[3]

Question 2 for Board members
Do you agree that the Board should amend IFRS 17 to require an entity, in the circumstances described in paragraph 14 of this paper, to use a systematic and rational method of allocation to apply the requirements in IFRS 17 relating to the recovery of losses from reinsurance contracts held, as described in paragraph 16 of this paper?

C—Insurance revenue—income tax

Sweep issue

19. The Board is amending IFRS 17 to resolve an inconsistency between paragraph B66(f) and paragraph B65(m) of the Standard. After that amendment, an entity would apply paragraph B65(m) of IFRS 17 to include in the fulfilment cash flows the income tax payments and receipts that are specifically chargeable to the policyholder under the terms of an insurance contract.

20. The intended consequence of the amendment is for an entity to recognise insurance revenue for the consideration paid by the policyholder for the income tax amounts described in paragraph 19 of this paper in a manner consistent with the recognition of insurance revenue for other incurred expenses applying IFRS 17. However, to achieve this intended consequence, the staff note that a further amendment is needed to one of the paragraphs containing the revenue requirements in IFRS 17.

[3] In addition to the drafting in Appendix A to this paper, there would be consequential amendments to the related requirements for transition to IFRS 17 and for contracts acquired in a transfer of insurance contracts that do not form a business or in a business combination within the scope of IFRS 3 *Business Combinations*.

Staff analysis and recommendation

21. An entity accounts for the income tax amounts described in paragraph 19 of this paper applying IAS 12 *Income Taxes.* The entity also includes those amounts in the fulfilment cash flows applying IFRS 17. Accordingly, when income tax expenses that are specifically chargeable to the policyholder under the terms of an insurance contract are recognised applying IAS 12, an entity will treat them as incurred expenses applying IFRS 17. That means that when an entity incurs income tax expenses that are specifically chargeable to the policyholder under the terms of an insurance contract, the entity will need to reduce the liability for remaining coverage and recognise insurance revenue.

22. However, paragraph B121 of IFRS 17 describes the consideration from a policyholder that determines insurance revenue as covering:

    (a) insurance service expenses, excluding specified amounts relating to loss components;

    (b) the risk adjustment for non-financial risk, excluding specified amounts relating to loss components;

    (c) the contractual service margin; and

    (d) amounts related to insurance acquisition cash flows.

23. The list in paragraph B121 of IFRS 17 is exhaustive. Therefore, to enable an entity to recognise insurance revenue as described in paragraph 21 of this paper, that list needs to be amended to include income tax expenses incurred that are specifically chargeable to the policyholder under the terms of an insurance contract. If such an amendment was not made, the entity would need to present income other than insurance revenue for the amount of consideration related to those income tax expenses.

24. Therefore, the staff recommend the Board amend IFRS 17 as described in paragraph 23 of this paper. Appendix A to this paper sets out recommended drafting for that recommended amendment.

Question 3 for Board members

Do you agree that the Board should amend IFRS 17 to require an entity to recognise insurance revenue when the entity recognises in profit or loss amounts related to income tax that are specifically chargeable to the policyholder under the terms of an insurance contract?

D—Definitions of the liability for remaining coverage and the liability for incurred claims

Sweep issue

25. During the Board's redeliberations, the staff noted that some respondents to the Exposure Draft *Amendments to IFRS 17* had raised comments or questions regarding the definitions of the liability for remaining coverage and the liability for incurred claims, and that the staff would consider those comments in drafting the final amendments.

26. The definitions, amended as proposed in the Exposure Draft, are as follows:

Liability for incurred claims

An entity's obligation to:

(a) investigate and pay valid claims for insured events that have already occurred, including events that have already occurred but for which claims have not been reported, and other incurred insurance expenses; and

(b) pay amounts under existing insurance contracts that are not included in (a) for which an entity no longer provides an investment-return service or an investment-related service.

Liability for remaining coverage

An entity's obligation to:

(a) investigate and pay valid claims under existing insurance contracts for insured events that have not yet occurred (ie the obligation that relates to the unexpired portion of the insurance coverage); and

(b) pay amounts under existing contracts that are not included in (a) for which an entity will provide an investment-return service or an investment-related service.

27. Some respondents said that the proposed definitions reflect some, but not all, of an entity's obligations arising from insurance contracts. For example, an entity might have an obligation to pay other amounts relating to the provision of insurance contract services—such as refunds of premiums to the policyholder or expenses payable to third parties. In addition, an entity might have an obligation to pay amounts not related to the provision of insurance contract services—such as some types of investment components. The carrying amount of a group of insurance contracts is the sum of the liability for remaining coverage and the liability for incurred claims, and the measurement reflects all of an entity's obligations arising from the group of insurance contracts (see paragraph 40 of IFRS 17). Some respondents suggested the Board amend the definitions of the liability for remaining coverage and the liability for incurred claims for completeness to reflect all obligations arising from insurance contracts issued by an entity, consistent with the requirements for measuring those liabilities.

Staff analysis and recommendation

28. The staff agree that the definitions of the liability for remaining coverage and the liability for incurred claims do not provide a complete list of all obligations giving rise to cash flows that are included in the measurement of the insurance contract liability.

29. Therefore, the staff recommend the Board amend IFRS 17 to include in the definitions of the liability for remaining coverage and the liability for incurred claims all obligations arising from insurance contracts issued by an entity. Appendix A to this paper sets out recommended drafting for that recommended amendment.

Question 4 for Board members
Do you agree that the Board should amend IFRS 17 to include in the definitions of the liability for remaining coverage and the liability for incurred claims all obligations arising from insurance contracts issued by an entity?

E—Variable fee approach—applying together the OCI option and the risk mitigation option

Sweep issue

30. The OCI option in IFRS 17 has two methodologies for determining the amount of insurance finance income or expenses to be recognised in profit or loss. An entity can choose whether to include part of insurance finance income or expenses in OCI (rather than entirely in profit or loss), but if it chooses to use OCI it cannot choose which methodology to apply for determining the amounts in profit or loss and OCI—the methodology depends on the circumstances:

    (a) if the group of contracts is a group of variable fee approach contracts and the entity holds the underlying items, the entity must use the current period book yield (paragraph 89 of IFRS 17); and

    (b) for all other groups of contracts, the entity must use an effective yield approach (paragraph 88 of IFRS 17).

31. An entity applying the OCI option and that is required to use the current period book yield might also elect to apply the risk mitigation option in IFRS 17. If so, an accounting mismatch will arise as described in paragraphs 32–34 of this paper.

Staff analysis and recommendation

32. The conditions set in paragraph 89 of IFRS 17 for qualifying for the current period book yield require the entity to hold 100% of the underlying items, being the 100% of the underlying items that the entity is obliged to pay to the policyholder. The current period book yield eliminates an accounting mismatch by requiring the entity to recognise insurance finance income or expenses in profit or loss at the same amount the entity recognises in profit or loss from the underlying items. The Board intended paragraph 89 of IFRS 17 to apply only when there can be no economic mismatches between the underlying items held as assets and the effect of the participation in those assets under the insurance contracts. If the entity holds less than 100% of the underlying items, then economic mismatches will exist and the current period book yield is not an appropriate methodology.

33. If the risk mitigation option is not applied, the only insurance finance income or expenses arising on the insurance contracts relate to the effect of the underlying items, because all other financial changes adjust the contractual service margin. However, if the risk mitigation option is applied, insurance finance income or expenses arise from both the underlying items *and* the mitigated financial risks on cash flows that do not vary depending on returns on underlying items (fixed cash flows). IFRS 17 does not have specific requirements on how the OCI option should be applied to the latter. Therefore, if the entity holds the underlying items, paragraph 89 of IFRS 17 (the current period book yield) continues to apply.

34. The result is that the amount of insurance finance income or expenses recognised in profit or loss would continue to be the same as the amount recognised in profit or loss from the underlying items (because that is what the current period book yield requires), and hence all insurance finance income or expenses on the mitigated financial risks would be included in OCI. That result seems counterintuitive because *all* the financial changes on the mitigated risks would be included in OCI, including interest calculated on a cost basis. It also creates a mismatch with the profit or loss amount on the assets used to mitigate the risks in the fixed cash flows. For example, the change in value of a financial asset measured at fair value through profit or loss used to mitigate risks would be recognised in profit or loss, but the corresponding change in the insurance contract liability would be recognised in OCI.

35. This issue was discussed as a sweep issue in April 2019, and the Board decided not to take any action. Agenda Paper 2C *Sweep issues* of the April 2019 Board meeting argued that entities could choose to reduce accounting mismatches between:

    (a) mitigated fixed cash flows in the insurance contracts and derivatives, by using the risk mitigation option; *or*

    (b) participation cash flows in the insurance contracts and underlying items held, by using the OCI option.

36. However, for groups of insurance contracts that qualify for the current period book yield, an entity cannot avoid a mismatch if it applies both the risk mitigation option *and* the OCI option. The staff now accept that is an unintended restriction on the application of these options.

37. The staff therefore recommend the Board amend the OCI option and the risk mitigation option in IFRS 17 to:

    (a) specify that paragraphs 88 and 89 of IFRS 17 do not apply to insurance finance income or expenses that arise from the application of the risk mitigation option; and

    (b) add new requirements to the risk mitigation option that specify how to present insurance finance income or expenses that arise from the application of the risk mitigation option. Those requirements would require an entity to present such insurance finance income or expenses in a way that best matches the changes in the mitigating instrument—ie the entity would present:

        (i) changes in the insurance contract liability that are mitigated using financial assets measured at fair value through profit or loss in profit or loss; and

        (ii) changes in the insurance contract liability that are mitigated using reinsurance contracts held applying the same OCI accounting policy the entity has chosen for the mitigating reinsurance contracts held.

38. Appendix A to this paper sets out recommended drafting for that recommended amendment.

Question 5 for Board members

Do you agree that the Board should amend IFRS 17 to:

(a) specify that paragraphs 88 and 89 of IFRS 17 do not apply to the insurance finance income or expenses that arise from the application of the risk mitigation option; and

(b) add new requirements to the risk mitigation option that specify how to present insurance finance income or expenses that arise from the application of the risk mitigation option, as described in paragraph 37 of this paper?

Appendix A—recommended drafting

A1. This appendix sets out recommended drafting relating to the staff recommendations in this paper. Additions are underlined and deletions are struck through. Text that is not underlined or struck through is the text from IFRS 17 as originally issued in 2017, or, if applicable, the text as proposed in the Exposure Draft.

A—Pre-recognition cash flows other than insurance acquisition cash flows (paragraphs 7–11 of this paper)

Contractual service margin

38 The contractual service margin is a component of the asset or liability for the group of insurance contracts that represents the unearned profit the entity will recognise as it provides insurance contract services in the future. An entity shall measure the contractual service margin on initial recognition of a group of insurance contracts at an amount that, unless paragraph 47 (on onerous contracts) applies, results in no income or expenses arising from:

(a) the initial recognition of an amount for the fulfilment cash flows, measured by applying paragraphs 32–37.~~;~~

(b) the derecognition at the date of initial recognition of any asset recognised for insurance acquisition cash flows applying paragraph 28C and any other asset or liability previously recognised for cash flows related to the group of contracts. Cash flows are related to the group of contracts if they would have been included in the fulfilment cash flows at initial recognition of the group had they been paid or received after that date.~~; and~~

(c) any cash flows arising from the contracts in the group at that date.

Presentation in the statement of financial position

…

79 An entity shall include any assets for insurance acquisition cash flows recognised applying paragraph 28B(b)<u>, and any other assets or liabilities for cash flows related to a group of contracts that occur before the group is recognised,</u> in the carrying amount of the related portfolios of insurance contracts issued, and any assets or liabilities for cash flows related to portfolios of reinsurance contracts held (see paragraph 65(b)) in the carrying amount of the portfolios of reinsurance contracts held.

B—Reinsurance contracts held—identifying losses on underlying insurance contracts (paragraphs 12−18 of this paper)

Reinsurance contracts held—recognition of recovery of losses on underlying insurance contracts (paragraphs 66A–66B)

…

<u>B119G Onerous underlying insurance contracts might be included in a group of insurance contracts with other onerous contracts that are not covered by a group of reinsurance contracts held. In that case, for the purpose of applying paragraphs 66A–66B, the entity shall apply a systematic and rational method of allocation to determine the portion of losses recognised on the group of insurance contracts that relates to underlying insurance contracts. The entity shall apply the same systematic and rational method of allocation to determine the portion of changes in the loss component of the group of insurance contracts that relates to underlying insurance contracts when applying paragraph 66(c)(ii).</u>

C—Analysis of insurance revenue—income tax (paragraphs 19−24 of this paper)

Insurance revenue (paragraphs 83 and 85)

…

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

<u>(ia) amounts related to income tax that are specifically chargeable to the policyholder;</u>

(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.

D—Definitions of the liability for remaining coverage and the liability for incurred claims (paragraphs 25−29 of this paper)

Appendix A Defined terms

…

Liability for incurred claims

An entity's obligation to:

(a) investigate and pay valid claims for insured events that have already occurred, including events that have occurred but for which claims have not been reported, and other incurred insurance expenses; and

(b) <u>pay amounts that are not included in (a) and that relate to:</u>

<u>(i) insurance contract services that have already been provided; or</u>

<u>(ii) any investment components or other amounts that are not related to the provision of insurance contract services and that have been transferred from the liability for remaining coverage.</u>

~~(b) pay amounts under existing insurance contracts that are not included in (a) for which an entity no longer provides an investment-return service or an investment-related service.~~

Liability for remaining coverage

An entity's obligation to:

(a) investigate and pay valid claims under existing insurance contracts for insured events that have not yet occurred (ie the obligation that relates to the unexpired portion of the insurance coverage); and

(b) <u>pay amounts under existing insurance contracts that are not included in (a) and that relate to:</u>

<u>(i) insurance contract services not yet provided (ie the obligations that relate to future provision of insurance contract services); or</u>

<u>(ii) any investment components or other amounts that are not related to the provision of insurance contract services and that have not been transferred to the liability for incurred claims.</u>

~~(b) pay amounts under existing contracts that are not included in (a) for which an entity will provide an investment-return service or an investment-related service.~~

E—Variable fee approach—applying together the OCI option and the risk mitigation option (paragraphs 30–38 of this paper)

Insurance finance income or expenses (see paragraphs B128−B136)

…

<u>87A An entity shall apply:</u>

<u>(a) paragraph B117A to insurance finance income or expenses arising from the application of paragraph B115 (risk mitigation); and</u>

<u>(b) paragraphs 88 and 89 to all other insurance finance income or expenses.</u>

88 In applying paragraph 87A(b), unless ~~Unless~~ paragraph 89 applies, an entity shall make an accounting policy choice between:

(a) …

89 In applying paragraph 87A(b), for ~~For~~ insurance contracts with direct participation features, for which the entity holds the underlying items, an entity shall make an accounting policy choice between:

(a) …

Risk mitigation

…

B117A If the entity mitigates the effect of financial risk using derivatives or non-derivative financial instruments measured at fair value through profit or loss, it shall include insurance finance income or expenses for the period arising from the application of paragraph B115 in profit or loss. If the entity mitigates the effect of financial risk using reinsurance contracts held, it shall apply the same accounting policy for the presentation of insurance finance income or expenses as the entity applies to the reinsurance contracts held applying paragraphs 88 and 90.