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IFRS 17 INSURANCE CONTRACTS: EXPOSURE DRAFT OF PROPOSED CHANGES

In June 2019 the International Accounting Standards Board (IASB) is expected to publish a new IFRS 17 exposure draft (ED) with a shortened 90 day comment period to reflect updates to the new standard.

The key changes to IFRS 17 to be proposed by the IASB are summarized below.

Effective date

The IASB is expected to amend the effective date of IFRS 17 from Jan. 1, 2021 to Jan. 1, 2022. Additionally, the fixed expiry date for the temporary exemption to IFRS 9 in IFRS 4 is expected to be deferred by one year so that all insurance entities must apply IFRS 9 for annual periods on or after Jan. 1, 2022. An entity could choose to apply IFRS 17 before that date but only if it also applies IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers.

Scope changes

The ED is expected to scope out loans where the only insurance risk in the contract relates to the settlement of some or all of the obligations created by the contract. This change permits an entity to elect to apply IFRS 9 in its entirety rather than IFRS 17. The update addresses concerns where some loans that transfer significant insurance risk needed to be accounted for as insurance contracts.

Credit cards that do not consider insurance coverage in the pricing of the credit card contract are expected to be scoped out from IFRS 17. The IASB confirmed accounting for these contracts under IFRS 9 provides useful information and that accounting for the contracts under IFRS 17 might impose costs and disruption.

Acquisition costs

The ED will introduce new guidance that allows an asset to be recognized for certain acquisition costs allocated to expected contract renewals that are part of the insurance acquisition cash flows directly attributable to newly issued contracts.

Previously acquisition cash flows could not be deferred outside of the contract boundary. This update is being made to reflect that some commissions paid relate to contracts that will be renewed in the future, sometimes more than once. The recoverability of the asset is based on expected fulfilment cash flows of the related group of contracts.

Additionally, for acquisition costs allocated to future renewals, the ED will introduce new disclosure requirements for reconciliations of opening to closing balances, as well as quantitative disclosure in appropriate time bands of the expected inclusion of these acquisition cash flows in the measurement of the related group of insurance contracts.

Financial risk mitigation

The ED is expected to expand the scope of the risk mitigation exemption for insurance contracts with direct participation features. The exemption still covers when derivatives are used but now also includes when entities use reinsurance contracts to mitigate financial risk. This change addresses situations where reinsurance held may act in the same mitigating way as derivatives. The ED will permit entities under certain conditions to recognize changes in financial risk from reinsurance in profit or loss instead of adjusting the Contractual Service Margin (CSM).

CSM

For contracts with direct participation features, the ED is expected to clarify that the coverage period includes periods in which entities provide investment related services or coverage for insured events. This change addresses when quantity of benefits includes investment related services and when coverage duration includes periods when there is no insurance coverage but there are investment related services.

For contracts without direct participation features, the ED is expected to require entities to allocate the CSM based on coverage units that consider insurance coverage and investment return services. The IASB indicated including an investment return service in the determination of coverage units could reduce the differences between the general model and the variable fee approach through the pattern of recognition of the contractual service margin in profit or loss.

The ED will also amend CSM disclosures where the coverage units are determined by considering both insurance and investment services coverage. The ED is expected to require quantitative disclosure in time bands of expected recognition of CSM in profit or loss at the end of the reporting period. This removes the previous disclosure option of providing only qualitative information. Additionally the ED will require disclosure of the approach to assessing relative weighting of insurance and investment related services or investment return services.

Investment components definition

An update to the definition of an investment component is expected to be part of the annual improvements included in the new ED. The ED is expected to define an investment component as the amount that the contract requires the entity to repay to a policyholder in all circumstances, regardless of whether the insured event occurs. This new definition helps clarify for example that refunds of premium are not an investment component.

Reinsurance held

For reinsurance held that provides coverage on a proportionate basis and where the underlying insurance contracts issued are onerous on initial recognition, the ED will require entities to recognize a gain on the reinsurance held at the same time as the underlying onerous loss is recognized. This update addresses previous reinsurance accounting mismatches in the profit and loss account between reinsurance held and underlying contracts when the underlying contracts are onerous.

Presentation

The ED is expected to make a key change to the requirements for statement of financial position presentation of insurance assets and insurance liabilities. The change will require portfolios of insurance assets to be separately presented from portfolios of insurance liabilities. Reinsurance portfolios held that are assets should also be separately presented from reinsurance portfolios that are liabilities. This change is expected to alleviate concerns about the prior requirement of IFRS 17 to present groups of contracts that are in an asset position separately from groups of contracts in a liability position in the statement of financial position.

Transition

The ED is expected to allow entities to apply the risk mitigation option prospectively from the IFRS 17 transition date provided that the entity designates its risk mitigation relationships to apply the risk mitigation option no later than the IFRS 17 transition date. The change is being made to address concerns that previously IFRS 17 allowed the risk mitigation option only to be used prospectively from the date of initial application of IFRS 17 even though risk mitigation activities may have been in place before that date.

The ED is also expected to update the modified retrospective approach transition requirements for a liability that relates to the settlement of claims incurred before an insurance contract was acquired. The ED will require an entity to classify such liabilities as a liability for incurred claims. This update addresses concerns around acquired contracts that are managed in the same system as contracts that have been issued by the entity. Acquired contracts may be managed in a manner that makes it impracticable to distinguish them from issued contracts.

The ED is expected to permit an entity applying IFRS 17 retrospectively to a group of insurance contracts with direct participation features to use the fair value transition approach for the group if such contracts meet specific criteria. The IASB considers information provided applying the fair value transition approach provides useful information to the users of financial statements.

Annual improvements

A number of annual improvements are also expected to be included in the ED, which seek to clarify existing guidance as opposed to introducing significant new requirements. For more information about the annual improvements, please refer to the IASB website.

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