

18 August 2022

Bruce Mackenzie
Chair
IFRS Interpretations Committee
Columbus Building
7 Westferry Circus
Canary Wharf
London
United Kingdom

Dear Mr Mackenzie

Tentative agenda decision – Multi-currency Groups of Insurance Contracts (IFRS 17 and IAS 21)

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretations Committee's publication in the July 2022 Update of the tentative agenda decision not to take onto the Committee's agenda the request for clarification on:

- a. whether an entity considers currency exchange rate risks when applying IFRS 17 to identify portfolios of insurance contracts; and
- b. how an entity applies IAS 21 in conjunction with IFRS 17 in measuring a group of insurance contracts that generate cash flows in more than one currency (a multi-currency group of insurance contracts).

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda for the reasons set out in the tentative agenda decision.

However, we question whether the following statement in the tentative agenda decision is consistent with the requirements of IFRS 17 (emphasis added):

In applying IFRS 17, there is a single contractual service margin for the group of insurance contracts.

Accordingly, if an entity were to determine that for the purpose of applying IAS 21 the contractual service margin is denominated in the multiple currencies of the cash flows in the group, the entity would:

- a. *assess whether the group of contracts is onerous considering the contractual service margin as a single amount, **after translation into the functional currency**; and*
- b. *determine the amount of the contractual service margin to recognise in profit or loss by applying a single method of determining the coverage units provided in the current period and expected to be provided in the future.*

The inclusion of the effects of foreign currency translation in the accounting for the contractual service margin of a group of contracts does not appear to be in line with the requirement of IFRS 17:B97(a)(i) which requires the effect of financial risk to be excluded from estimated future cash flows. As such, we believe that this paragraph forbids the inclusion of the effect of financial risk and changes in financial risk in the adjustment required by IFRS 17:44(c).

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The IFRS 17 guidance noted above would suggest that the increase or decrease of the fulfilment cash flows that adjusts the contractual service margin would need to be calculated "before" the retranslation into the functional currency. In fact, for groups with multiple currencies that are different from the functional currency, the adjustment to the contractual service margin should exclude the effect of the changes in those rates.

The sequence of calculation and the use of line items that feed the mandatory insurance service result vs. the insurance finance income or expenses amount needs to be consistent with the fact that the fulfilment cash flows are translated at current rates at the reporting date in the same way as they are remeasured at current discount rate (another financial variable). We believe paragraphs BC274 and BC275 in the IFRS 17 basis for conclusion offer a valid analogy between discount rates and foreign exchange rates for the Committee to consider (emphasis added):

*From BC274: The contractual service margin does not represent future cash flows; it represents the unearned profit in the contract, measured at the point of initial recognition and adjusted only for specified amounts. For insurance contracts without direct participation features, **the contractual service margin is not adjusted (remeasured) for changes in interest rates** for the reasons set out in paragraphs BC228–BC231.*

*From BC275: To make the contractual service margin internally consistent, the Board decided that the adjustments for changes in estimates of future cash flows also need to be measured at the rate that applied on initial recognition. **This leads to a difference between the change in the fulfilment cash flows and the adjustment to the contractual service margin—the difference between the change in the future cash flows measured at a current rate and the change in the future cash flows measured at the rate that had applied on initial recognition.** That difference gives rise to a gain or loss that is included in profit or loss or other comprehensive income, depending on the accounting policy choice an entity makes for the presentation of **insurance finance income or expenses**.*

By analogy, the use of current exchange rates for the fulfilment cash flows would not flow directly through the adjustment to the contractual service margin and they should instead be considered as an amount in insurance finance income or expense. IFRS 17 applies this principle for foreign exchange gains and losses through the requirement of paragraph IFRS 17:92, which states:

"an entity includes exchange differences on changes in the carrying amount of groups of insurance contracts in the statement of profit or loss, unless they relate to changes in the carrying amount of groups of insurance contracts included in other comprehensive income applying paragraph 90, in which case they shall be included in other comprehensive income."

We believe that when "an entity were to determine that for the purpose of applying IAS 21 the contractual service margin is denominated in the multiple currencies of the cash flows in the group", the adjustment to the contractual service margin should be considered in the context of the multiple currencies of the group. These may or may not include the functional currency. The accounting for the contractual service margin should take in to account the requirement of IFRS 17:B97. Finally, we believe that the outcome of that choice in the financial statements should be aligned with all of the IFRS 17 requirements as it would be when an entity determines that the contractual service margin "is denominated in a single currency".

We are conscious that the absence of guidance in the IFRS Accounting Standards on the denomination of contracts with multiple currencies would still result in accounting diversity. However, consideration of the points above would limit the diversity in this area.

Finally, we believe that a clear direction on this issue from the Committee would benefit related areas of accounting under IFRS 17 and IAS 21. In particular, the accounting for the risk adjustment for non-financial risks included in the carrying amount of a group of insurance contracts for which the currency denomination would be similarly assessed. While the risk adjustment for non-financial risks is not bound by the prescribed level of aggregation in IFRS 17 that applies to the contractual service margin, the clarity on the interplay between IFRS 17 and IAS 21 that would be obtained from this tentative agenda decision would benefit users, preparers and their auditors.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

A handwritten signature in grey ink, appearing to read 'V Poole', with a stylized flourish at the end.

Veronica Poole
Global IFRS and Corporate Reporting Leader