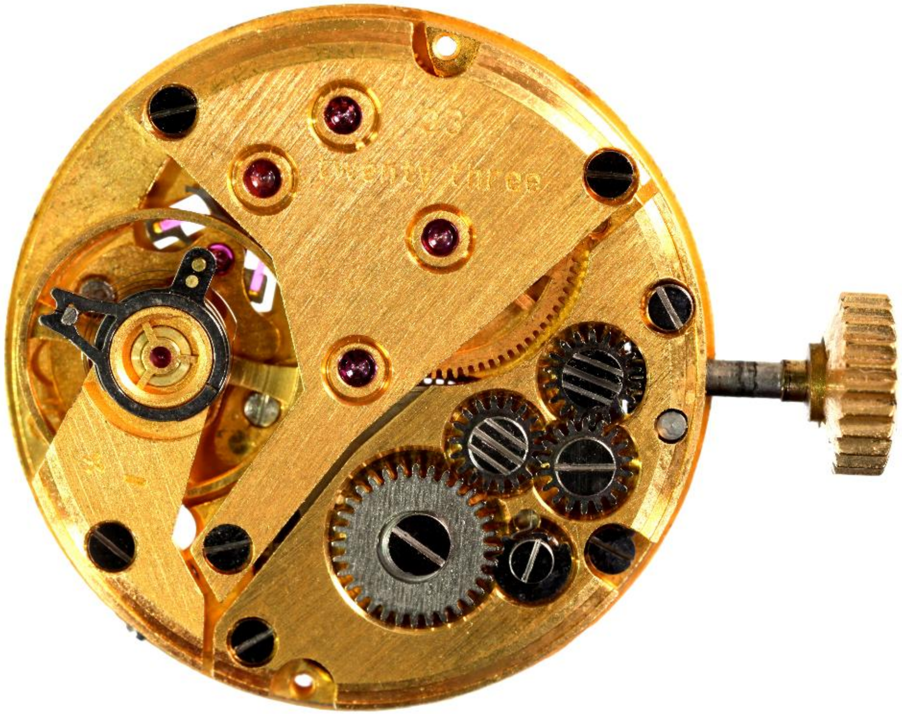


# IFRS 4 Phase II will be IFRS 17, effective from 1/1/21

## Many changes approved on the likely final meeting of the multi-year insurance contracts project

Francesco Nagari, Deloitte Global IFRS Insurance Leader | 22 November 2016

# Agenda

- Highlights of the IASB meeting on 16 November 2016
- IASB Staff analysis, IASB discussion and tentative decisions
- Next steps

# Highlights of November IASB meeting

- The effective date is set for 1 January 2021 on the assumption IFRS 17 (official new name for IFRS 4 Phase II) is published by June next year
- The papers were extensive (177 pages in total)
- Major sources of Staff proposals were the field testing work and the confidential review analyses conducted during the summer months
- Transition is fundamentally simplified from prior decisions with new choices available across previously mandated restatement methods
- The fair value approach restatement can have a much wider application than before
- Level of aggregation is also simplified with a minimum of two groups per year, per portfolio. The linkage with the portfolio definition is clarified. Previously approved criteria to make groups open ended have been removed
- VFA criteria and mutualisation have been clarified with an overall positive outcome

# Mandatory effective date of IFRS 17

## Staff Analysis

- The complexity of IFRS 17 is as great as the complexity of implementing other Standards recently issued, and is probably most comparable to banks applying the new expected credit loss model in IFRS 9
- Need to balance the advantages of a longer implementation period against the disadvantages of allowing inferior accounting practices to continue
- Given the operational complexity, data gathering and systems implications of implementing IFRS 17, a period of approximately three years is appropriate
- The long implementation period of between 3.5 and 4 years between the issuance date of IFRS 17 and the mandatory effective date may assist entities in meeting any increased regulatory capital requirements that follow the reporting of higher liabilities
- The possible effect of regulatory capital requirements should not delay the implementation of a Standard intended to provide transparency and comparability to investors

# Mandatory effective date of IFRS 17

## Staff Recommendation

- An entity should apply IFRS 17 for annual periods beginning on or after 1 January 2021, assuming that IFRS 17 is issued in the first half of 2017
- An entity may apply IFRS 17 before 1 January 2021, provided it also applies IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers at the same time

# Mandatory effective date of IFRS 17

## Board discussion and decision

- One Board member considered that a period of 5 years was preferable to enable all companies (particularly smaller insurers and those in developing economies) to implement the new Standard at the same date
- He considered that there would only be marginal benefits in implementing IFRS 17 at the date recommended, and that the marginal costs would be huge
- Several Board members disagreed with this view, particularly as the new Standard was a significant improvement over current accounting.
- They also noted that projects done for extensive periods are generally not very efficient, smaller companies generally have fewer products, approximately 3 years was considered sufficient by most respondents to the 2013 ED and companies already have had plenty of time to consider the proposals

### Tentative decision

- The Board approved the Staff recommendations with only one Board member voting against it

# Transition requirement significantly simplified

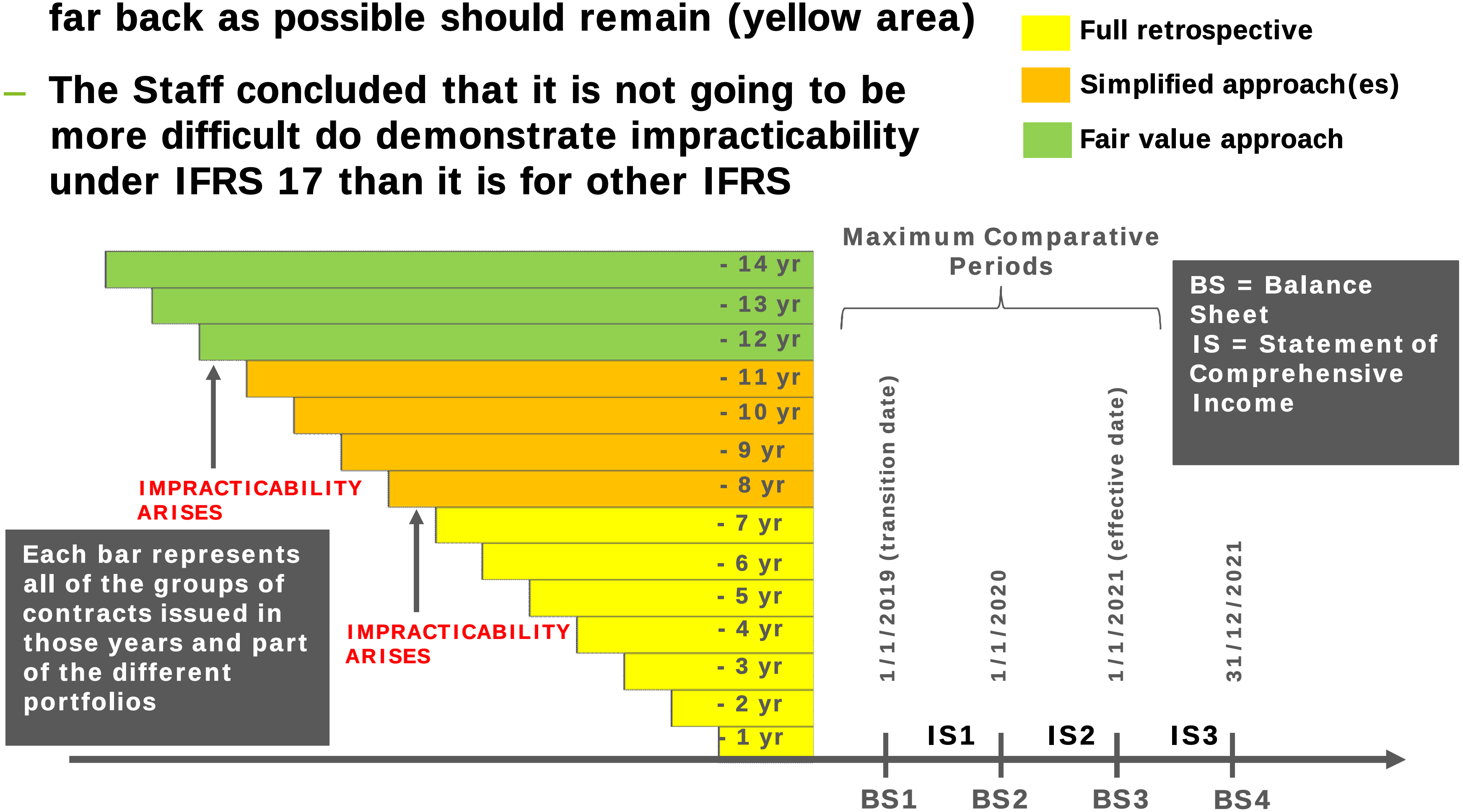
## Staff Analysis

- Transition issues identified during the field testing stimulated the Staff analysis that produced an extensive range of recommendations which have substantially simplified the transition requirements under IFRS 17:
  1. Impracticability criteria for restatement purposes;
  2. Use of different sources of data for the modified/simplified restatement;
  3. Reference date for the VFA modified/simplified restatement approach;
  4. Fair value approach and the size of the restated CSM;
  5. Grouping of contracts not fully restated;
  6. Disclosures on transition processes and amounts
- For each of these six issues the Staff conducted an analysis of the outcomes from the field testing and set out recommendations to respond to any concerns they deemed valid to improve the IFRS 17 transition approach

# Transition requirement significantly simplified

## Staff Analysis – Impracticability criteria for restatement purposes

- The key principle of applying full restatement as far back as possible should remain (yellow area)
- The Staff concluded that it is not going to be more difficult do demonstrate impracticability under IFRS 17 than it is for other IFRS



# Transition requirement significantly simplified

## Staff Recommendation and Board decision – Impracticability criteria for restatement purposes

- **Demonstrate impracticability before using simplified or fair value approaches**

- **Requirements of IFRS 17 should be applied retrospectively in accordance with IAS 8 to groups of contracts unless doing so is impracticable**

- **For insurance contracts for which a group cannot be identified retrospectively, and for groups for which retrospective application is impracticable, permit a choice between a modified retrospective approach or the fair value approach**

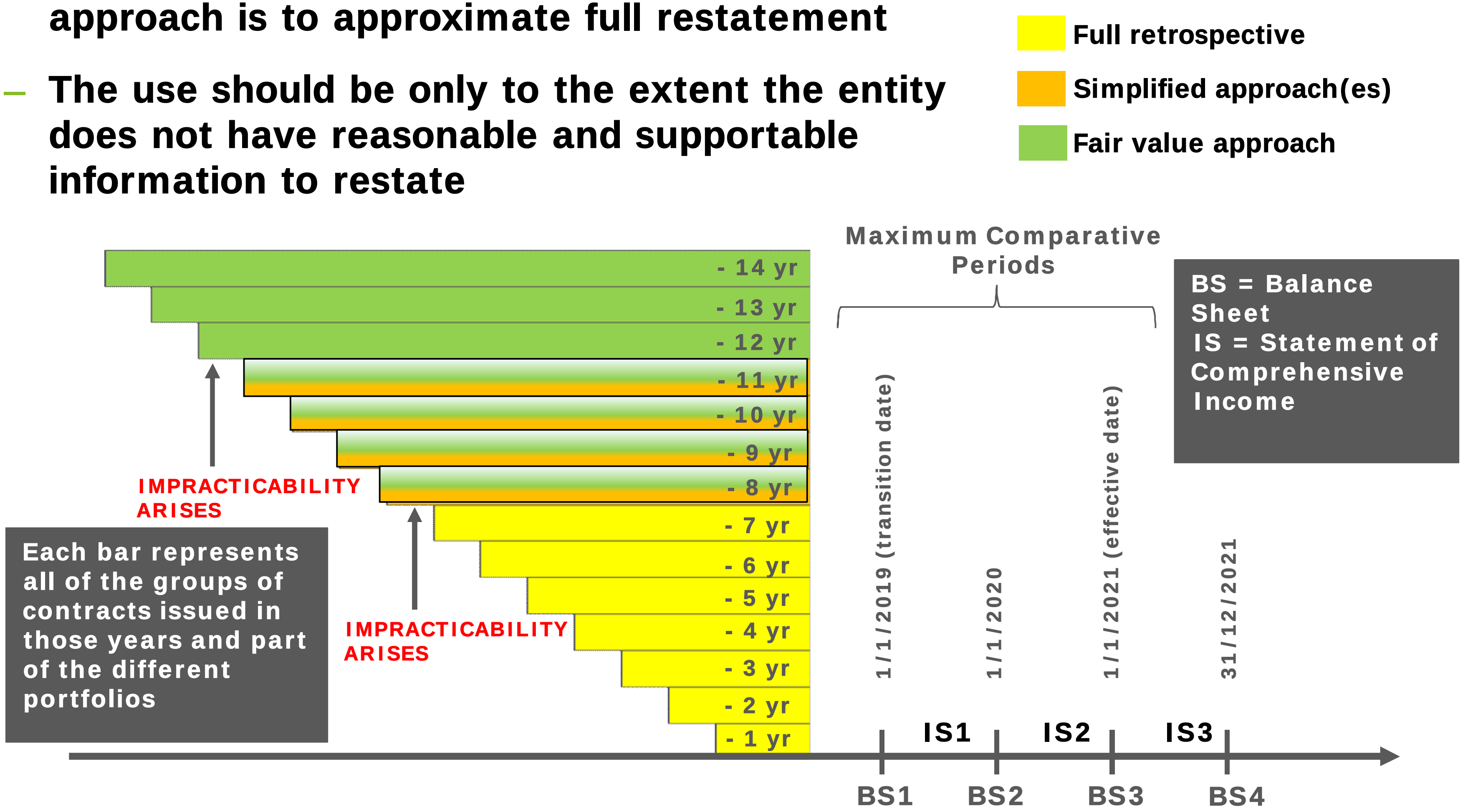
## Tentative decision

- **The Board agreed with the principle of maximum use of full restatement and approved unanimously the introduction of the permission to choose between the simplified approach and the fair value approach**

# Transition requirement significantly simplified

## Staff Analysis – Modified retrospective approach

- The objective of the modified retrospective approach is to approximate full restatement
- The use should be only to the extent the entity does not have reasonable and supportable information to restate



# Transition requirement significantly simplified

## Staff Recommendation and Board decision – Modified retrospective approach

### Modified retrospective approach

- Objective of a modified retrospective approach is to achieve the closest outcome to retrospective application possible using reasonable, supportable information
- Use of specified modifications should be permitted, using minimum modifications necessary to meet the objective of the modified retrospective approach
- Applying modified retrospective approach should make maximum use of information that would have been used to apply a fully retrospective approach, but need only use information available without undue cost or effort.

### Tentative decision

- The Board agreed with the additional modifications and approved unanimously that their use should be the minimum necessary to meet the objective of the modified retrospective approach

# Transition requirement significantly simplified

## Staff Recommendations and Board decision – Fair Value approach and VFA simplified

- The Fair Value approach will be applicable more extensively
- In that instance a number of assessments can be done either at the inception of the contract (normal approach supported by evidence contemporary to the inception date) or at the transition date (the beginning of the earliest period presented). These assessments are:
  1. Eligibility for the VFA;
  2. How to group contracts fair valued;
  3. How to determine the effect of discretion for indirect par contracts
- In addition, when the VFA simplified approach is utilised, the restated CSM is set at transition date rather than at the date of initial application (the effective date for calendar year entities)

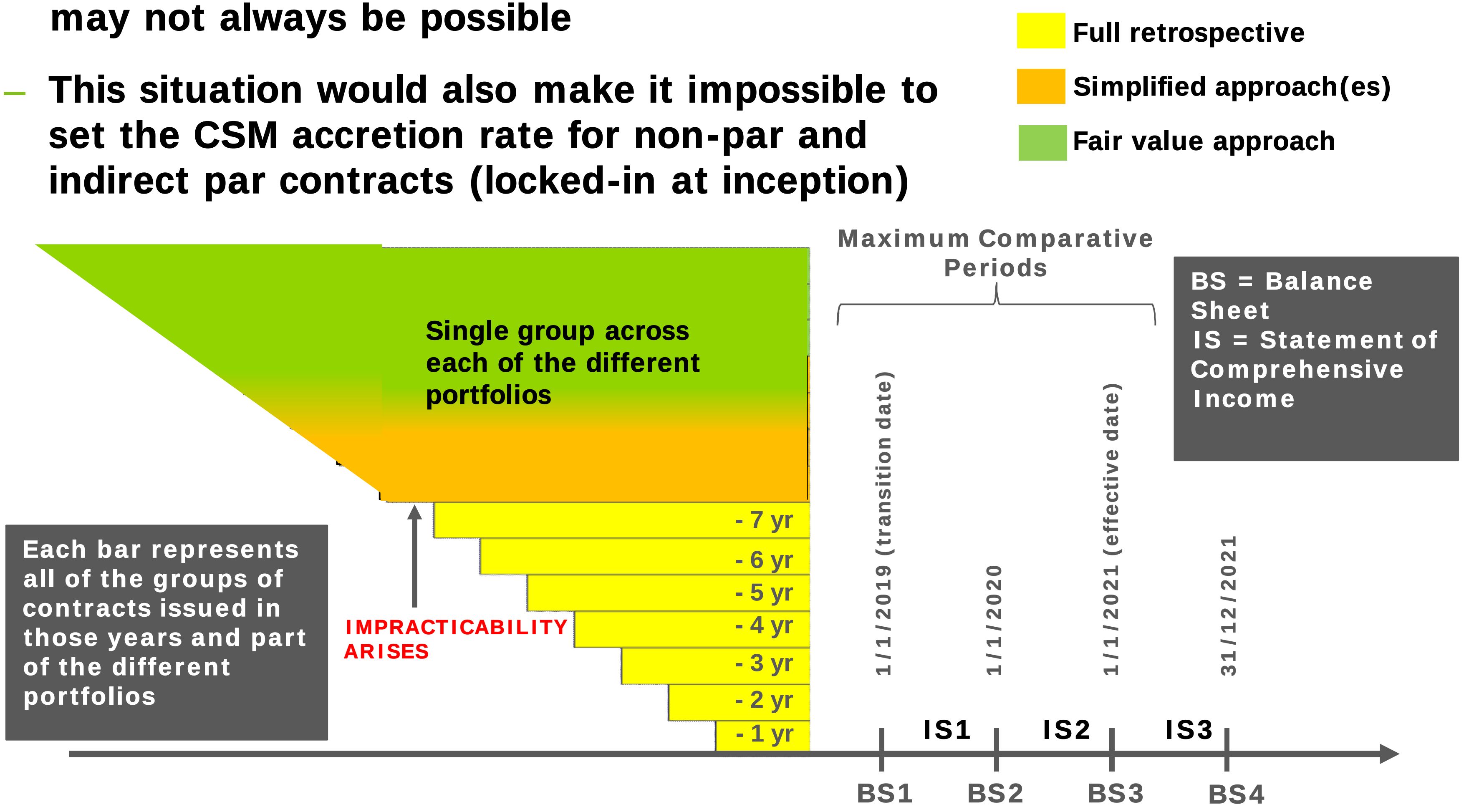
## Tentative decision

- The Board approved these recommendations unanimously

# Transition requirement significantly simplified

## Staff Analysis – Grouping of contracts not fully restated

- The Staff concluded that the grouping by period may not always be possible
- This situation would also make it impossible to set the CSM accretion rate for non-par and indirect par contracts (locked-in at inception)



# Transition requirement significantly simplified

## Staff Recommendations and Board decision – Grouping of contracts not fully restated

- An entity would be permitted keep contracts in the same group even if they were written in different years
- The accretion rate for the CSM (non-par and indirect par) and for the OCI solution (non-par) would be set at transition date. This means the differential between market discount rates at the inception of the contract and those at transition date is ignored. The CSM is implicitly reset by reference to the same market discount rate used for the fulfilment cash flows at transition date.
- For those entities using the OCI solution this approach means an accumulated OCI balance set to zero.
- The effect of past contracts no longer in-force at transition date on the transition CSM for contracts not fully restated is assumed to be nil.

### Tentative decision

- The Board approved these recommendations unanimously. One Board member commented that these recommendations were an extraordinarily generous concession

## Transition requirement significantly simplified

### Staff Recommendations and Board decision – Disclosures on amounts reported at transition

- All the disclosures required by IFRS 17 relating to the CSM, insurance contract revenue and insurance finance income or expenses should be provided separately for insurance contracts that existed at the beginning of the earliest period presented and for insurance contracts written after that date
- Explain how determined the measurement of insurance contracts at transition for all periods in which disclosures are provided for the insurance contracts that existed at the beginning of the earliest period presented to help users understand the nature and significance of the methods used and judgements applied
- Disclose a reconciliation between the opening and closing balance of the cumulative amounts included in OCI for financial assets at FVOCI if those assets are related to those insurance contracts where the accumulated OCI was set to nil.

### Tentative decision

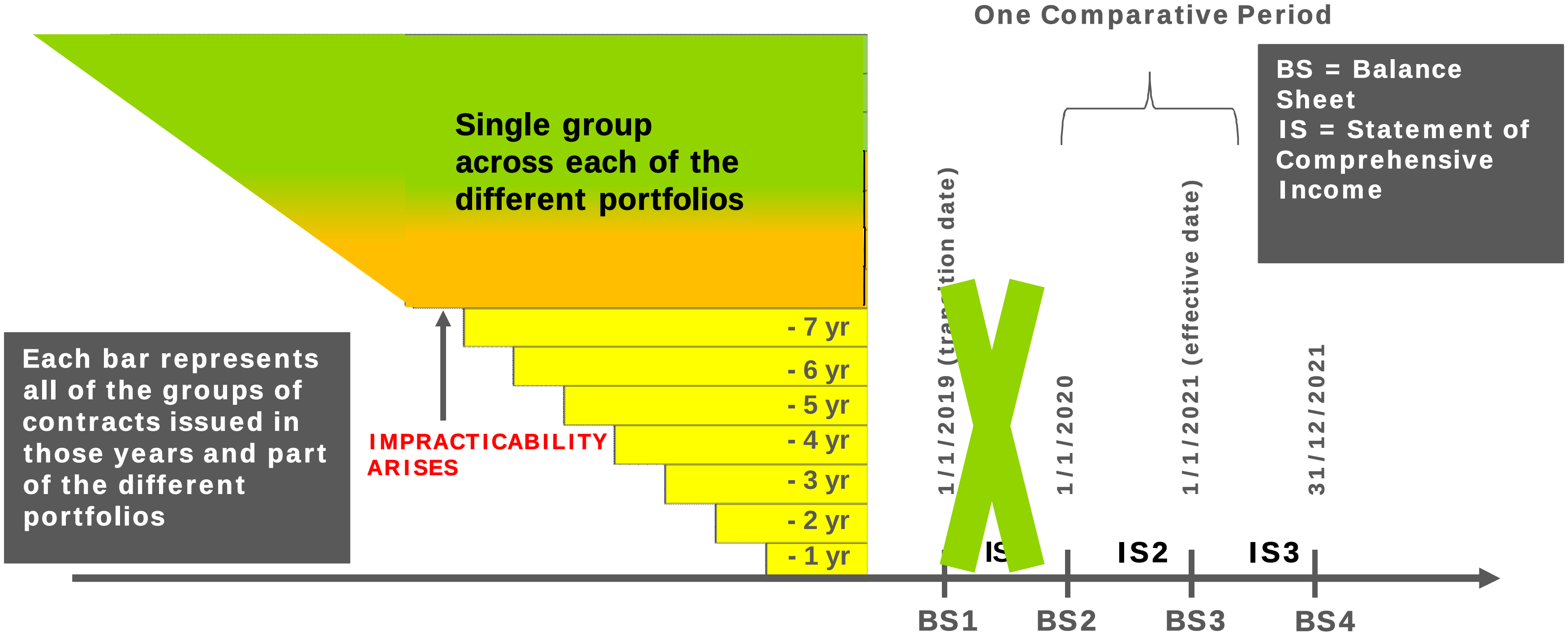
- The Board approved these recommendations unanimously.

# Transition requirement significantly simplified

## Staff Recommendation and Board decision – Comparative periods (paper 2G issue 17)

- The Staff recommended that similarly to IFRS 10 and IFRS 12 a relief is given from the requirement to present an additional comparative period.
- The Board approved this unanimously.

Full retrospective
Simplified approach(es)
Fair value approach



## Level of aggregation

## Reducing the number of groups and removing the open ended criteria except for mutualised contracts

### Staff analysis

**Portfolio**
- Similar risks
- Managed together
- Open-ended
- Product group is a valid example

| Year X | Year X+1 | Year X+2 |
|---|---|---|
| Highly profitable group | Highly profitable group | Highly profitable group |
| Other profitable group | Other profitable group | Other profitable group |
| | Onerous group | |

## Level of aggregation

### Reducing the number of groups and removing the open ended criteria except for mutualised contracts

**Staff recommendation**

- **The definition of portfolio should be retained, with further guidance that contracts within each product line would be expected to have similar risks, and hence contracts from different product lines would not be expected in the same portfolio**
- **Onerous contracts should be identified based on available information at inception and grouped separately from contracts that are not onerous at inception**
- **Insurance contracts that are not onerous at inception should be measured by dividing portfolios, at a minimum, into a group of contracts that have no significant risk of becoming onerous and a group of other profitable contracts. Further guidance to be provided on how to assess the risk of contracts becoming onerous**
- **Only contracts issued within the same year should be included within the same group**

## Level of aggregation

## Reducing the number of groups and removing the open ended criteria except for mutualised contracts

### Staff recommendation (cont.)

- **The CSM for a group of contracts would be allocated over the current period and expected remaining coverage on the basis of coverage units, reflecting the expected duration and size of the contracts in the group**
- **A weighted-average discount rate permitted for the accretion of interest on the CSM, with an averaging period of up to one year.**

### Tentative decision

- **The Board approved these recommendations unanimously**

- ***In paper 2G the Staff recommends to add further guidance on how an entity should reflect mutualisation on the level of aggregation. It may result in contracts with mutualisation being effectively open-ended as far as the unlocking adjustments are concerned (see paper 2C paragraphs 36-39)***
- ***The Board approved all 21 recommendations in paper 2G unanimously***
- ***There is no additional clarity at this stage on this key point***

# Variable Fee Approach criteria

## Use of substantive obligations in reference to "contractual terms"

### Staff recommendation

- In paper 2G issue 12 the Staff recommends to clarify that the "contractual terms" referred to in the first of the VFA criteria is to refer to all substantive obligations that are enforceable:
  - *"The <u>contractual terms</u> specify that the policyholder participates in a share of a clearly identified pool of underlying items (emphasis added)"*
- The Standard will explain that enforceable obligations may come from contract, <u>law or regulations</u>
- The Standard will also confirm that while a contract can arise because of constructive obligations (as defined in IAS 37), not all constructive obligations would give rise to contracts as defined in the Standard and in IFRS 15 *Revenue from Contracts with Customers*

### Tentative decision

- As noted earlier all recommendations in paper 2G were approved unanimously

## Other Sweep Issues

### Accounting for experience variances and related changes in the estimate of future cash flows (paper 2C)

NEW

Experience adjustment with impact on changes in future cash flows

Changes in estimates of future cash flows

Experience adjustment with NO impact on changes in future cash flows

Changes in estimates of future cash flows

P&L

**Tentative decision**

**The Board approved this approach with one vote against ten in favour**

CSM

# Other Sweep Issues

## Risk mitigation (paper 2F)

- The Staff analysed a number of findings from the field testing related to topic 3 which covered the new form of hedge accounting available for contracts under the VFA
- The Staff acknowledged that some accounting mismatch remained if the new Standard made the hedge accounting to be restricted to certain risks
- The Staff recommended that the new Standard permits an entity that applies the VFA and uses the VFA hedge accounting to do so for all financial risks reflected in the insurance contract

### Tentative decision

- The Board approved this recommendation unanimously

# Insurance contracts

## Next steps

- The Staff will continue with the drafting process to:
  - reflect the decisions made in the November 2016 meeting in a revised draft of IFRS 17; and
  - ask selected external parties to perform a fatal flaw review of an updated draft of IFRS 17.
- The Staff expects to issue IFRS 17 in the first half of 2017.
- The IASB technical plan indicates that March 2017 is the "expected publication date"
- The IASB has been seeking views from its advisory councils on the merit of setting up a Transition Resource Group

## Contact details

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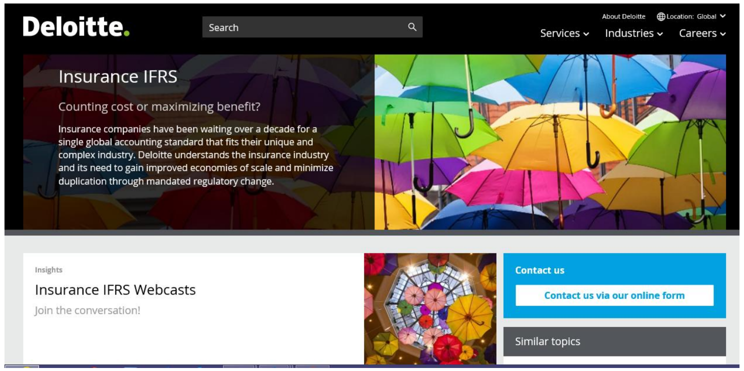

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