

IFRS in Focus

Fourth Transition Resource Group meeting discussing the implementation of IFRS 17 *Insurance Contracts*

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This *IFRS in Focus* summarises the meeting of the IFRS 17 Transition Resource Group (TRG) which took place on 4 April 2019.

Introduction

The TRG is a discussion forum established by the International Accounting Standards Board (IASB) to support the implementation of IFRS 17 *Insurance Contracts*. The purpose of the TRG is:

- To invite discussion and analysis of potential stakeholder issues arising from the implementation of the new insurance Standard
- To provide a public forum for stakeholders to learn about the new insurance accounting requirements
- To help the IASB determine whether additional action is needed, such as providing clarification or issuing other guidance

During the meeting the TRG members share their views on the issues discussed, followed by a meeting summary issued by the IASB. Reflecting on the issues raised, the IASB will decide whether any action is required.

This was the fourth meeting where submissions to the group were discussed. The Chair noted that an increasing number of submissions are with regard to more mechanical and fact-specific aspects of the IFRS 17 implementation. He commented that to answer submissions at such level of detail is not within the remit of the TRG. In addition, he reiterated that the IASB strategy in organising its support to the IFRS 17 implementation included a long enough period of calm from any interpretative public discussions. Such period of “radio silence” would encourage preparers to focus on their implementation processes. That is why, at this point, there are no further TRG meetings scheduled. However, the TRG remains in place for the time being and submissions are always welcome.

Visit the [IASB website](#) for more information about the TRG, including agenda papers that further describe the topics below.

Agenda Paper 1—Investments components within an insurance contract Background

The IASB has received a number of submissions about investment components and their definition in IFRS 17. The TRG has received queries as to how to determine whether an insurance contract includes an investment component and, if yes, how to assess whether it is distinct and how to determine its amount when it is non-distinct.

In terms of determining whether an investment component exists, the Staff observes that the definition of an investment component refers to a payment that is required, even if an insured event does not occur (IFRS 17:Appendix A).

The Staff believes that the Board’s intention with regard to what constitutes an investment

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component is clear, however, the submissions to the TRG demonstrated that the words in the definition are open to misinterpretation. The Staff thinks it is worth clarifying that an insurance contract only includes an investment component if the contract requires an entity to repay an amount to the policyholder in **all circumstances**.

For example, an uncancellable "whole of life" insurance contract that requires an entity to pay an amount when the policyholder dies, includes an investment component, because the entity is required to pay the amount in all circumstances as death is certain. However, an uncancellable contract that requires an entity to pay an amount only if the policyholder survives to a specified age, but does not require the entity to pay any amount if the policyholder dies before that, does not include an investment component.

In performing this assessment, the entity does not consider a scenario for which no payment is made if that scenario has no commercial substance. The Staff also notes that in some scenarios the amount of payment could be zero. That does not necessarily mean that no investment component exists. For example, nil payments may be made because the entity uses the investment component to settle an obligation due from the policyholder, or because of a payment that an entity makes to the policyholder early in the coverage period that might reduce the investment component to nil later in the coverage period.

IFRS 17 requires an investment component to be separated if, and only if, it is distinct. That is the case if the investment component and the insurance component are not highly interrelated (Condition 1) or a contract with equivalent terms is or could be sold separately in the same market or the same jurisdiction (Condition 2).

Condition 1 is not met if, and only if, the entity is unable to measure one component without considering the other or the policyholder is unable to benefit from one component unless the other is also present.

The Staff explained that if the value of the payment depends on whether the insured event occurs, they would see a high interrelation between the amounts associated with the two components, hence Condition 1 would not be met. There is also an indication that Condition 1 is not met if an investment component and an insurance component cannot be sold separately in the market. If the lapse or maturity of one component causes the lapse or maturity of the other component, Condition 1 is also not met.

If the timing of the payment of the investment component depends on the death of the policyholder, Condition 2 is not met. While an instrument paying fixed amounts for a defined period of time starting from inception would be available on the market where the entity operates, such an instrument would typically not include the uncertainty about the timing of payment of any amounts depending on the death of the policyholder.

IFRS 17 does not specify how to determine the amount of non-distinct investment components that an entity is required to exclude from insurance revenue and insurance service expenses. The Staff observed that an approach for determining the amount of a non-distinct investment component that is based on a present value basis as at the time of making this determination would be consistent with the requirements of IFRS 17:B21. The additional amounts, compared to the amounts payable if the insured event did not occur, referred to in IFRS 17:B21, result in the contract being defined as an insurance contract. In the Staff's view, the present value of the additional amounts comprise the insurance component of the contract, so the present value of the amounts repayable in all circumstances, represents the investment component.

The TRG was asked for their views.

Discussion

The TRG members welcomed the paper, with one TRG member stating that breaking the issue down in three questions (Is there an investment component? Is it distinct? How is a non-distinct investment component measured?) illustrates well how the Standard intended to account for investment components.

On the first question, some of the TRG members expressed concern with regard to the proposed amendment to the definition of an investment component. Many thought that the question about the existence of an investment component is interconnected with the question about measurement. Some members were concerned that the new definition that will be proposed in the Exposure Draft would narrow the population of investment components.

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Some were concerned about the measurement and some about the disclosure. One concern was the need to consider all scenarios. An example cited by a TRG member was a unit-linked product that could result in no pay-out in the event of decline in the investment component down to nil due to the fall to nil of the value of the linked investment fund. Such an investment unit-linked insurance contract does have a scenario where there is no repayment. In those circumstances the amended definition would appear to preclude an investment component being identified. The TRG member commented that this would be counter-intuitive.

The Staff paper has also an example of a deferred annuity where a policyholder shares in the returns on underlying items and when it reaches a pre-determined age the policyholder has the option to either surrender the contract for cash or to turn it into an annuity for life. In the agenda paper, footnote 2 states that "as a development of the Staff analysis included in Agenda Paper 2E Recognition of the Contractual Service Margin in Profit or Loss in the General Model for the January 2019 Board meeting, the Staff observe that an insurance contract with no guaranteed payments in the annuity phase would include an investment component if the contract had a surrender amount and the policyholder had an option to either use that surrender amount to buy an annuity or take the surrender amount." In a deferred annuity, once the policyholder takes an annuity option, the payments become life-contingent and may even be nil in case of an early death, so the clarification in the Staff papers that there would still be an investment component was seen as helpful by this TRG member. However, the logic used was seen as too specific to the fact pattern and in many cases, explicit surrender values would be an easier concept to apply to identify investment component.

One TRG member was concerned about whether the IASB wanted to draw the line between a premium refund and an investment component outflow and if so, suggested to add the concept of premium refund to IFRS 17. Observing Board members agreed that this should be considered. However, another TRG member said that adding a third outflow category ('premium refund') would disrupt implementation, given the outcome would be similar, i.e. for presentation it would not affect insurance revenue or insurance service expenses. A few other TRG members echoed this concern and questioned the requirement to consider premium refunds and investment components separately when there is no impact on presentation. One TRG member noted that there would actually be a different impact on profit from treating payments as premium refunds compared to what happens to investment components. When an insurer refunds premium to a policyholder there will be impact in profit or loss if revenue had already been recognised for a service that is now no longer provided. In that case, revenue would have to be reversed. Similarly if the refund accelerates the release to profit or loss of the remaining contractual service margin the insurer would report a positive increase in insurance revenue. These occur because the premium refund amount does not necessarily mirror the pattern of service provision estimated at a group of contracts level applying concepts of coverage units.

The Staff clarified that insurers would not have to assess all of their surrender values to distinguish any investment component from premium refunds. Instead, the Staff intended that simple insurance contracts, like car insurance, where the policyholder receives money back when they cancel, do not have to be assessed for an investment component only because there is an amount that is refundable, as there is no investment component, because the refund is not available at maturity of the contract hence there are circumstances where the repayment to the policyholder can be avoided.

The Vice-Chair of the IASB highlighted that with the proposed amendment to the contractual service margin allocation, which is based on the existence of an investment component, the definition becomes more important hence a clarification is deemed to be helpful. It is not the Board's intention to narrow or widen the population of investment components from the one that was intended in the first place. Preparers ought to consider whether they may have a larger or narrower population of contracts with investment components. The submissions to TRG on this topic are evidence that the understanding among preparers is not uniform.

One member thought that the Staff analysis about the presence of an investment component in cases with no cash outflows to policyholders changes the definition of investment component. The two examples provided in the agenda paper were very surprising in the member's opinion. The first of the two examples has no payments on early surrender. The Staff analysed this nil cash flow as the net amount of a payment of investment component to the policyholder and a payment of surrender charges by the policyholder that are equal to or higher than investment component. In other words, the investment component is used to pay surrender charges. The second example was

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the deferred annuity with no guaranteed payments. Other TRG members later echoed these concerns about a gross/net basis for identification of investment components. In terms of distinction between investment components and premium refund, the TRG member saw a difference even in measurement. The investment component is always repaid, so in measurement its cash flow has a probability of 1. The premium refund is not always refunded, so that cash flow has a probability of less than 1.

Picking up on disclosure concerns and the need to either have separate lines in the reconciliations in IFRS 17:103 or to combine premium refunds and investment components in a single line item that is appropriately renamed, the Board members and Staff decided to respond to this as part of the Annual Improvements agenda paper presented to the IASB.

On the first question, the Staff summarised that some TRG members would appreciate clarification to the definition of investment component, while some think it is not necessary or could even be disruptive to implementation. The disclosure in IFRS 17:103 regarding investment components may also need to be reconsidered to accommodate premium refunds.

On the second question, one TRG member introduced an example of a participating contract where the insurer holds the dividends matured from the contract in a separate deposit account which is created because the policyholder decides not to collect the cash due. If the base contract lapses, the insurer requires the policyholder to close down the deposit account and makes the repayment at that point in time. The TRG member said that this would not be a distinct investment component. The Staff emphasised that they would not like to discuss specific fact patterns, but would not object to that conclusion. The TRG generally agreed with the Staff's analysis and one TRG member highlighted that distinct investment components in contracts would not be very common.

The Staff summarised on the second question that the TRG observes that the threshold for separating investment components is quite high.

With regard to the third question, one TRG member emphasised that IFRS 17 does not require an entity to calculate the present value of the investment component and that this was just one example of how it could be done. One TRG member agreed with the Staff's analysis that if there is no contractual cash surrender value, then a measurement would have to take place. Another TRG member said that a principle-based approach to measurement will lead to different outcomes for different models, which might be difficult to accept in practice.

In summarising the TRG's view with regard to the third question, the Staff said that when they talk about measurement, they mean the amount that is taken out of insurance revenue and insurance service expenses. This measurement only happens at that point. If the investment component is implicit, the insurer needs to determine it. This can be done by taking, for example, the present value of its maturity amount. If there is an explicit amount, that amount should be taken and no further action is required. In some cases the surrender value is the investment component.

One TRG member responded to the summary that IFRS 17 would not allow for the discount rate that should be used to measure the present value of the maturity amount of an investment component to be different to the discount rate that is used in measuring the fulfilment cash flows of the insurance contract.

Agenda Paper 2—Reporting on other questions submitted

Background

This paper includes all topics that have not been discussed in a separate agenda paper. Those topics came from submissions that were rejected for inclusion in a particular TRG agenda paper because they can be answered by applying only the words in IFRS 17, do not meet the submission criteria or are being considered outside of TRG (for example by way of an active Board discussion in its Annual Improvement process).

This *IFRS in Focus* only lists the submissions that were discussed in the TRG meeting. For a comprehensive list of all 43 rejected submissions please see [Agenda Paper 2](#) of the April 2019 TRG Meeting.

Discussion

S86—Definition of a portfolio when determining the boundary of a contract

With regard to this submission, the Staff concluded that a 'portfolio of insurance contracts' is a defined term in IFRS 17 and that there is no difference between the use of that defined term in different paragraphs of IFRS 17.

One TRG member stated that this clarification is helpful.

S92—Policyholder dividends

The submission is about policyholder dividends for specific contracts accounted for applying the general model.

The Staff concluded that changes in fulfilment cash flows that result from changes in underlying items, such as the entity's profit, should be treated for the purposes of IFRS 17 as changes in investments and therefore as changes in assumptions that relate to financial risk. As such, applying IFRS 17:87, their impact on the fulfilment cash flows is included in insurance finance income or expenses. The Staff will consider whether this needs to be clarified through an Annual Improvement in the forthcoming Exposure Draft.

One TRG member welcomed the clarity of the Staff response for this issue. Another TRG member was surprised with the conclusion that everything that results from an underlying item is a financial risk. This might affect the usefulness of financial statements. The Staff replied that the submission introduced a general model contract with underlying items and the submitter asked whether they have to look through to the underlying item to distinguish financial and non-financial cash flows. The Staff concluded that in the general model the contractual service margin is not adjusted for changes in underlying items. This is planned to be clarified by way of an amendment.

Further, the response to submission flagged that the standard is unclear whether the total amount of policyholder dividends not yet allocated to individual policyholders should be considered as a liability for remaining coverage or an incurred claim. As part of drafting the forthcoming Exposure Draft, the Staff plans to consider the effect of the amendments related to the inclusion of an investment related service or an investment return service when identifying coverage units on the distinction between liability for incurred claims and liability for remaining coverage for amounts related to the investment component.

S96 & S107—Definition of an insurance contract and contract boundary

S96 asks whether the contract boundary requirements in IFRS 17:33–35 apply to the assessment of whether a contract meets the definition of an insurance contract, or whether they apply only to the measurement of contracts that have already been determined to meet the definition of an insurance contract.

S107 questions how a contract which transfers insurance risk after a period of time, as discussed in IFRS 17:B24, should be classified.

The Staff concluded that for a contract to meet the definition of an insurance contract there needs to be a transfer of significant insurance risk. IFRS 17:B24 explains that when contracts transfer insurance risk only after an option is exercised, they do not meet the definition of insurance contracts at inception. An entity should consider the requirements of other IFRS Standards to account for such contracts until they become insurance contracts.

A contract which only transfers insurance risk after a period of time is different than an insurance contract that provides an option to add further insurance coverage to a contract where transfer of significant insurance risk existed at inception (refer to Agenda Paper 3 of the May 2018 TRG meeting).

One TRG member highlighted that IFRS 17:B24 contains two options: one where the price for the insurance is set, and one where it is not set. The reference should be clear that it only refers to the option where the price is not set, when saying that the contract does not meet the definition of an insurance contract.

S98—Exercising an option included within the contract

The submission asks how the exercise of an option to convert a contract to a different type of contract should be treated.

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The Staff analysed the issue with reference to previous TRG discussions. Agenda Paper 3 at the May 2018 TRG meeting analysed when cash flows arising from an option are within the boundary of the contract and notes that, applying IFRS 17:72, the exercise of a right included in the terms of a contract is not a contract modification. Agenda Paper 5 at the September 2018 TRG meeting analyses when cash flows are outside of the contract boundary at initial recognition and facts and circumstances change over time, the exercise of an option that is in the contract boundary and the exercise of an option that is outside the contract boundary. The VFA assessment is performed at inception of the contract in its entirety.

One TRG member found this clarification helpful. Another TRG member did not find the words in IFRS 17 clear enough to answer the question. In case of a deferred annuity contract where the returns are based on underlying assets, the contract would be accounted for applying the VFA until the annuity option is exercised and the underlying assets disappear. However, a contract cannot change from VFA accounting to the general model without a modification, which causes an issue if the exercise of an option does not qualify as a modification.

The Staff responded that the submission was focusing on an option that was within the contract boundary and the exercise of which is not a modification given the words in IFRS 17.

S101, S120 & S124—Changes in the risk adjustment for non-financial risk due to time value of money and financial risk

One of the submissions asks whether the portion of a change in the risk adjustment for non-financial risk due to the impacts of the time value of money and financial risk should be excluded from the change in the risk adjustment for non-financial risk that relates to future service which adjusts the contractual service margin.

Assuming the answer to this question is yes, the submissions question the discount rate (locked-in rate or current rate) that would be used to adjust the contractual service margin.

The Staff analyse that IFRS 17:B90 states that the risk adjustment for non-financial risk is included in the measurement of insurance contracts in an explicit way and is conceptually separate from the estimates of future cash flows and the discount rates that adjust those cash flows. Applying IFRS 17:81, an entity is not required, but may choose, to disaggregate the change in the risk adjustment for non-financial risk between the insurance service result and insurance finance income or expenses. IFRS 17:B96(d) requires that changes in the risk adjustment for non-financial risk that relate to future service adjust the contractual service margin. IFRS 17:B97 requires that for groups of insurance contracts without direct participation features the contractual service margin is not adjusted for the effect of time value of money and financial risks.

The Staff plan to clarify as an Annual Improvement in the forthcoming Exposure Draft that the choice when applying IFRS 17:81 would result in different adjustments made to the contractual service margin applying IFRS 17:B96. If an entity applies the disaggregation choice in IFRS 17:81, the adjustment to the contractual service margin will exclude the portion related to financial variables that is described in that paragraph. It can be concluded from this discussion that the portion of the changes that is not related to financial variables is taken in full to the contractual service margin and there is no need to determine a discount rate for it. It can also be concluded that when the option from IFRS 17:81 is taken the amount could be further split between profit or loss and other comprehensive income under IFRS 17:88 or IFRS 17:89.

One TRG member struggled with the fact that presentation choices could lead to different contractual service margin unlocking and allocations, which does not appear supported by the text in the Standard. The Staff clarified that conceptually, the application of IFRS 17:B96(b) is more consistent with the rest of the contractual service margin unlocking, but the standard does not require an entity to make a disaggregation in IFRS 17:81 regardless of the method used. When this choice is made there will be measurement consequences for that entity.

S106—Reassessing portfolios

The submission describes a situation in which portfolios of insurance contracts change due to the manner in which the entity manages its contracts and questions the impact of such a change on the group unit of account or the application of the OCI presentation option.

The Staff analysed that composition of the group is not subsequently reassessed (IFRS 17:24).

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The OCI presentation choice is available by portfolio (IFRS 17:B129) and applying IAS 8:13 means that an entity selects and applies its accounting policy consistently for similar portfolios of insurance contracts. Changes in accounting policies follow the requirements of IAS 8.

One TRG member asked what was meant by similar portfolios in that case, given that IFRS 17 allows a portfolio-by-portfolio choice and the reference to IAS 8:13 in IFRS 17:B129 requires an entity to consider the assets backing it, accordingly, a portfolio could not be similar if the assets are classified differently. The Staff confirmed that.

S109—Group insurance policies—retrospective rating agreements

The submission questions whether a payment under a retrospective rating agreement that would be considered a premium refund if it was paid to the policyholders, would still be considered as such if it is paid to the association or bank.

The Staff analyse that IFRS 17 requirements with respect to the presentation of amounts as a cost or a reduction in revenue, discussed at the September 2018 TRG meeting, are applicable to exchanges between the parties to an insurance contract—i.e. the party issuing the insurance contract and the party holding it.

The Staff observed that the accounting for exchanges of amounts related to insurance contracts between the entity and other parties, such as explained in the submission, should be considered using other IFRS guidance.

One TRG member struggled with the reference to the September 2018 TRG meeting, as the discussion there was only about reinsurance contracts. The Staff acknowledged this, however stated that they looked at the economic substance, which is relevant to other insurance contracts as well.

S111—Accounting for the reinstatement of a lapsed contract

The submission describes a contract with a feature that provides a policyholder of a contract that lapsed an option to reinstate the contract within a contractually specified period, as long as the contract had not been surrendered.

The Staff did not analyse the issue as providing detailed application guidance is not within the remit of the TRG.

One TRG member said that in their jurisdiction, a lapsed contract would be classified as liability for incurred claims. However, cash flows relating to the unexpired portion of the contract period, including the expected reinstatement, would have to be classified as a liability for remaining coverage applying IFRS 17. The Staff agreed with this analysis, but said the standard is clear already.

S114—Changes in the fair value of underlying items applying the variable fee approach (VFA)

The submission describes a fact pattern of a participating contract that share returns with policyholders by paying dividends. The dividends scale varies based on the market value returns with respect to economic experience of investments and a statutory basis for the non-economic experience—such as expenses and reinsurance contracts held.

Applying the VFA, the submission questions the measure of the change related to non-economic experience. The submission asks whether a statutory basis used to determine dividends can be treated as an IFRS measure or a fair value measurement.

The submission further considers the application of the option to disaggregate insurance finance income or expense between profit or loss and OCI and whether it is limited to financial income or expenses on underlying items held or any income or expense on underlying items held.

The Staff noted that applying IFRS 17:45, under the VFA an entity adjusts the contractual service margin of a group of contracts based on changes in the fair value of underlying items. Therefore, a statutory basis or an IFRS measure which are not fair value measurements cannot be used to determine the adjustment to the contractual service margin.

IFRS 17:89 permits a policy choice of disaggregating insurance finance income or expenses for the period to include in

profit or loss an amount that eliminates accounting mismatches with income or expenses included in profit or loss on the underlying items held. IFRS 17:B131 requires that applying this choice an entity includes in profit or loss expenses or income that exactly match the income or expenses included in profit or loss for the underlying items, resulting in the net of the two separately presented items being nil. Therefore, the income or expense on underlying items held is not limited to financial income or expense.

One TRG member observed that if the OCI option is applied and there are only investment assets, the net investment result should be nil. If there are other underlying items that are not investment assets (e.g. other insurance contracts or the entity's profit), these would not be recorded in the investment result. We note that there is a similarity in the response to S92 commented above insofar as the conclusion that underlying items that are not financial instruments would have an impact on the fulfilment cash flows measured at fair value and presented as insurance finance income or expense. In this instance there may not be an underlying item contribution to the profit or loss that is on an IFRS fair value basis and the entity would report an accounting mismatch in profit or loss or in profit or loss and OCI.

S115—Definition of insurance contracts with direct participation features—applying paragraph B101(b) of IFRS 17

The submission describes a unit-linked insurance contract for which the entity charges an asset management fee determined as a percentage of the fair value of the underlying items at the end of each period plus a fixed premium for mortality cover by reducing the underlying items at the beginning of each period. The submission questions the application of IFRS 17:B101(b) in determining whether a contract meets the definition of an insurance contract with direct participation features.

The Staff noted that IFRS 17:B101(b) requires that the entity expects to pay to the policyholder an amount equal to a substantial share of the fair value returns on the underlying items as a condition for meeting the definition of an insurance contract with direct participation features. Therefore, a determination based on any calculation other than a calculation of the policyholder's share in the fair value returns on the underlying items would be inconsistent with the requirements of IFRS 17.

The deduction of a premium for mortality cover from the underlying items is, in effect, an amount paid out of the policyholder's share. In other words, the policyholder's share includes that charge. However, an entity needs to also consider IFRS 17:B101(c) in determining whether the definition of an insurance contract with direct participation features is met. IFRS 17:B101(c) requires that the entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items. For the purposes of this condition an entity considers changes in any amounts to be paid to the policyholder regardless of whether they have been paid from the underlying items or not.

While a TRG member found this analysis helpful, there was still not a unanimous view on how to do the IFRS 17:B101(c) "test". The TRG member wondered whether an example could be developed to clarify this. Another TRG member appreciated the Staff view that the mortality cover is, in fact, a charge and is not part of the consideration required by IFRS 17:B101(b) as this affects many unit-linked products. One TRG member stated that the fact pattern only included a fixed mortality charge and asked what would happen in the case of a variable mortality charge also based on the fair value of the underlying items like the asset management fee described in the fact pattern. There would be opportunities for structuring by making the mortality charge as high as possible if an entity wanted to acquire the VFA classification, or vice versa. Another TRG member emphasised that there is not always a requirement to do a calculation to determine VFA eligibility. The Staff clarified that their analysis was based on the mortality charge being a fixed amount that did not interfere with the policyholder's share of return. Had the charge been variable fee based on a percentage of the fair value of the underlying items, the charge would have to be included in determining policyholder's share and the contract may not meet the IFRS 17:B101(b) VFA criterion. One TRG member questioned that even if the charge was fixed there were still structuring opportunities and the Staff responded by requiring to look at the overall substance of the charges and other terms of the contract.

S116—Applying paragraph 66(c)(ii) of IFRS 17 for reinsurance contracts held

The submission asked how IFRS 17:66(c)(ii) applies to scenarios where only some of the contracts in a group of underlying contracts are covered by a proportional reinsurance contract and where underlying insurance contracts, expected to be profitable, have not been recognised but cash flows related to them are included in the measurement of the reinsurance contract held. Following initial recognition of the reinsurance contracts held, the underlying

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contracts were issued as onerous contracts. IFRS 17:BC315 explain that to the extent the change in cash flows relating to loss component on insurance contracts issued matches the change in cash flows on the reinsurance contract held, the impact of recognising both changes in profit or loss results in a nil net impact. However, IFRS 17 does not prescribe how to determine the change in fulfilment cash flows of a reinsurance contract held that corresponds to the change in expected cash flows on insurance contract issued, and this requires judgement which depends on facts and circumstances.

Regarding the unrecognised insurance contracts, IFRS 17:66(c) is applicable to changes in fulfilment cash flows of a reinsurance contract that relate to future service. IFRS 17:B96–B100 includes the relevant requirements applicable to experience adjustments. The topic of reinsurance contracts held for onerous underlying insurance contracts is also being considered through a process other than TRG.

One TRG member highlighted that it is good to know for general insurers that the issue is still being considered.

S117—Premium waiver presentation in profit or loss

The submission questions whether an entity should exclude from revenue premiums waived as a result of an insured event or should account for them as part of insurance service expense (as an incurred claim).

The Staff noted that insured events give rise to claims. To the extent that a premium waiver results from an insured event, it is a claim. IFRS 17 requires an entity to recognise insurance service expenses for claims incurred in the period regardless of whether claims were settled net of premiums due. Treating premium waivers as claims is therefore consistent with the requirements of IFRS 17.

One TRG member said that stakeholders were concerned that this conclusion is different from what was discussed at the September 2018 TRG.

The Staff responded that in September, the TRG discussed whether a premium waiver is an insured event. In the case discussed, it was concluded that it was an insured event and it would be accounted for as a claim. In that case, the claim should be presented gross of the insurance revenue in the P&L. It may be useful to remember that in a fulfilment cash flow calculation for a group of contracts that offer a premium waiver the probability of such an event would be included as required under IFRS 17:33(a) and the expected value would have inflows from the contracts adjusted by the probability of the waiver being triggered. The occurrence of the event that actually triggers the waiver would result in future lost premiums being reported as insurance service expenses with the difference to the associated expected value reported as an experience variance in the period (disclosed under IFRS 17:104(b)(iii)).

S118—Consideration of reinsurance in the risk adjustment for non-financial risk

The submission questions whether the effect of reinsurance should be considered in calculating the liability for the risk adjustment for non-financial risk associated with the groups of contracts that have been reinsured.

The Staff noted that if an entity considers reinsurance when determining the compensation it requires for bearing non-financial risk related to underlying issued insurance contracts, the effect of the reinsurance (both cost and benefit) would be reflected in the risk adjustment for non-financial risk of the underlying insurance contracts. The Staff specified that there are circumstances in which the resulting risk adjustment for non-financial risk for reinsurance contract held could be nil because the risk adjustment liability would have already taken it into account and the recognition of a risk adjustment asset would duplicate the accounting of the reinsurance benefit. IFRS 17 does not specify the estimation techniques to be used to determine the risk adjustment for non-financial risk.

One TRG member highlighted that the example given in the agenda paper would not be the only way to arrive at the conclusion. Several TRG members echoed the concern. The Staff emphasised that examples are not supposed to restrict preparers to one method. The Staff wanted to highlight that when considering reinsurance in the risk adjustment liability, the preparer does not only consider the benefits of the reinsurance contract, but also its costs.

However, one TRG member was concerned with this interpretation. The consideration or non-consideration of reinsurance in determining the amount of the risk adjustment liability on insurance contracts issued was seen as an accounting policy choice rather than a real economic factor.

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If an entity considers its reinsurance contracts held and recognises a smaller risk adjustment liability on insurance contracts issued IFRS 17 does not offer guidance on how the entity reflects the impact of the risk of a reinsurer's non-performance. The reinsurance contract held could have a nil risk adjustment asset and the impairment calculations would not be visible to users because the risk adjustment asset is not recognised. The Staff responded that they think the risk adjustment liability inclusive of reinsurance held reflects the availability of reinsurance, as opposed to the specific reinsurance contract held. To the extent that a reinsurer's creditworthiness declines, this would be reflected in the entity's cost of reinsurance.

In response to this comment and other comments about different ways to measure risk adjustment, the Staff emphasised this is not a 'net treatment' of reinsurance contract held. The risk adjustment for reinsurance contract held is determined gross after considering the risk adjustment for insurance contracts issued, as opposed to considering a net position and then imputing the gross elements. Some members draw different conclusions from the examples in the paper.

The TRG member also questioned the impact of including the cost and benefit of reinsurance in the risk adjustment of insurance contract issued on the presentation of the impairment cost associated with a reinsurance contract asset. The smaller risk adjustment liability on insurance contracts issued recorded as a consequence of considering the availability of reinsurance, results in a smaller (or nil) risk adjustment asset for reinsurance contract held and the presentation of any impairment loss would be impacted by the smaller asset's carrying amount.

S119—Risk of non-performance of the issuer of a reinsurance contract held

The submission explains that non-performance risk of a reinsurer may incorporate different risks such as insolvency risk and the risks related to disputes and further negotiations. The submission questions whether these risks are identified as financial or non-financial risks and the impact this determination has on the measurement of reinsurance contracts held when determining the risk being transferred applying IFRS 17:64.

The Staff refer to IFRS 17:63 that specifically requires that estimates of the present value of expected cash flows should include the effect of any risk of non-performance by the issuer of the reinsurance contract including the effects of collateral and losses from disputes. Thus, the risk adjustment for non-financial risk of a reinsurance contract held reflects only the risks that the cedant transfers to the reinsurer. The risk of non-performance by the reinsurer is not a risk transferred to the reinsurer nor does it reduce the risk transferred to the reinsurer. It is only reflected in the present value of the future cash flows of the reinsurance contract held, similar to the treatment of financial risks.

IFRS 17:63 does not provide specific requirements on how to determine the effect of any risk of non-performance. IFRS 17:67 requires that changes in the fulfilment cash flows related to the risk of non-performance do not adjust the contractual service margin, therefore an entity recognises them in profit or loss. This treatment is consistent with the accounting treatment for financial risks.

A TRG member agreed that the risk of non-performance of the reinsurer cannot be included in non-financial risk as it is not a risk transferred. Instead, non-performance is built into the fulfilment cash flows. Some stakeholders think that this non-performance risk could then still be put into the risk adjustment.

The Staff emphasised that only risks that are transferred to the reinsurer can be included in the risk adjustment. The risk of non-performance is created by the reinsurance contract and it is not transferred to the reinsurer in the first place.

S121—Interest accretion on insurance acquisition cash flows

The submission questions whether IFRS 17 requires or permits an entity to accrete interest on the amount of insurance acquisition cash flows paid for determining the insurance revenue and insurance services expenses applying IFRS 17:B125.

The Staff noted that IFRS 17:B120 states that the total insurance revenue for a group of insurance contracts is the consideration for the contracts, i.e. the amount of premiums paid to the entity adjusted for a financing effect and excluding any investment components.

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IFRS 17:B125 requires that an entity shall determine insurance revenue related to insurance acquisition cash flows by allocating the portion of the premiums that relate to recovering those cash flows to each reporting period in a systematic way on the basis of the passage of time. An entity shall recognise the same amount as insurance service expenses.

A systematic way to recognise insurance service expenses and insurance revenue related to insurance acquisition cash flows does not preclude a way that considers an interest accretion.

One TRG member highlighted that 'systematic way' does not necessarily mean 'straight line'.

S122—Changes in fulfilment cash flows as a result of inflation

The submission questions whether changes in fulfilment cash flows as a result of changes in inflation assumptions are treated as changes in non-financial risk (and adjust the contractual service margin) or changes in financial risk for contracts measured under the general model.

The Staff noted that IFRS 17:B128 requires that for the purpose of IFRS 17:

- (a) assumptions about inflation based on an index of prices or rates or on prices of assets with inflation-linked returns are assumptions that relate to financial risk; and
- (b) assumptions about inflation based on an entity's expectation of specific price changes are not assumptions that relate to financial risk.

Cash flows that an entity expects to increase with an index are considered to be an assumption that relates to financial risks, even if they are not contractually linked to a specified index.

Several TRG members expressed concern for cases where preparers are using inflation indices to anticipate their future expense base for the fulfilment cash flows, e.g. an expectation that salaries will increase over time. Contrary to the Staff analysis, that variable was not seen as a financial risk. However, one TRG member said that this just means being careful in labelling internal assumptions and not calling them inflation based.

S123—Reassessment of premium allocation approach (PAA) eligibility and election

The submission questions whether an entity is required or permitted to reassess a contract's eligibility for the PAA and, as a result, to revoke its election to apply the approach. The submission further asks how such a transition from the premium allocation approach to the general model should be treated.

The Staff noted that once the PAA eligibility criteria are assessed at inception and the choice to apply PAA is made, the Standard does not require nor permit reassessment of the eligibility criteria or the election to apply the approach.

One TRG member said that, in general, it is not always clear in IFRS 17 when an election is an accounting policy or an accounting estimate.

Summary

The Staff summarised that the TRG finds many of the Staff responses helpful in terms of clarification. With regard to inflation (S122), some TRG members read the Staff response differently to what the Staff had actually intended. In addition, the analysis of the mortality charge in S115 only looks at a fixed charge and for cases, in which it is variable, it might be helpful to look deeper into the arrangement when determining VFA eligibility. In terms of determining the risk adjustment for reinsurance contracts held (S118 & S119), the Staff observed that risk adjustment is always entity-specific and that it should include only the risk that is transferred to the reinsurer. As regards underlying items (S92), it should be clear that in the general model, the contractual service margin is not adjusted for changes in the underlying items. If a preparer chooses to disaggregate the risk adjustment for financial and non-financial components (S101, S120 & S124), they would have to adjust the contractual service margin consistently with IFRS 17:B96(b).

IFRS in Focus

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