Proposed Amendments to IFRS17

IFRS 17 Executive Roundtable

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Agenda

IASB updates

1. IASB proposed amendments to MFRS 17

Oct 2018

Concerns and implementation challenges identified

Nov 2018

Effective date proposed to be deferred to 2022 (and for MFRS 9 deferral)

Dec 2018 to March 2019

Amendments proposed for:

- Balance sheet presentation of insurance contracts – Portfolio level
- Reinsurance of onerous contracts
- Risk mitigation exception for direct participating contracts
- Insurance acquisition cash flows for renewals
- Allocating the CSM to investment services under the general model
- Transition – Contracts acquired in their settlement periods
- A scope exclusion for some credit cards that provide insurance coverage
- Transition requirements for the risk mitigation option
- Disclosure requirements regarding insurance acquisition cash flows that relate to future contract renewals and the CSM allocation under the GMM to investment services.

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2. Balance sheet presentation of insurance contracts – Portfolio level

What's the issue?

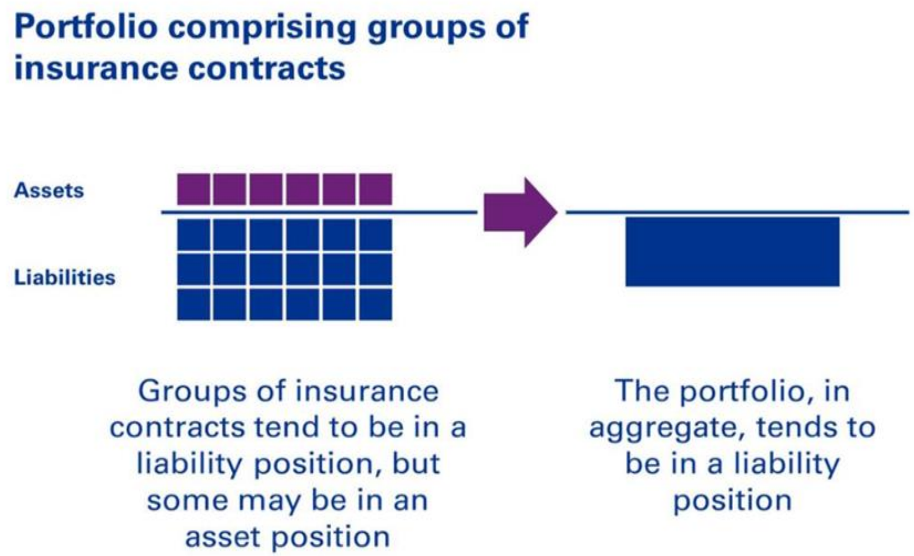
MFRS 17 currently requires separate presentation of groups of contracts that are assets and those that are liabilities.

Some insurers are concerned about the difficulty of allocating cash flows to individual groups due to system limitations.

What did the Board tentatively decide in December 2018?

To propose that this requirement applies to portfolios of insurance contracts, rather than groups.

This means that offsetting, for presentation purposes only, would be applied between groups in the same portfolio.



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3. Reinsurance of onerous contracts

What's the issue?

After initial recognition, if a group of underlying contracts becomes onerous, then the resulting changes in the fulfilment cash flows or reinsurance contracts held is recognised in profit or loss. This avoids accounting mismatches.

MFRS 17 currently requires an insurer to recognise losses when it initially recognises onerous contracts, but no corresponding gains even if the losses are covered by reinsurance contracts recognised at the same time. This can result in an accounting mismatch.

What did the Board tentatively decide in January 2019?

To propose that an insurer that recognises losses on underlying contracts on initial recognition to also recognise a gain at the same time in profit or loss on reinsurance contracts held, to the extent that the reinsurance contracts cover the losses of the underlying contracts on a proportionate basis.

— This gain would apply only to reinsurance entered into before, or at the same time as, the onerous underlying contracts are issued.

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3. Reinsurance of onerous contracts (cont'd)

Example: Reinsurance providing 50% proportionate coverage for two underlying groups of contracts

Underlying groups (two years' coverage period)	Profitable	Onerous
Premiums	800	200
Outflows	(600)	(300)
CSM (loss component)	**200**	**(100)**

Reinsurance providing 50% proportionate coverage	
Premiums	500
Inflows (900 × 50%)	(450)

	Before amendments		After amendments	
	Year 1	Year 2	Year 1	Year 2
Insurance revenue	500	500	500	500
Insurance service expenses	(500)*	(400)	(500)*	(400)
	-	100	-	100
Reinsurance premiums	(250)	(250)	(250)	(250)
Amounts recovered	225	225	**250****	200
	(25)	(25)	-	(50)
Insurance service result	(25)	75	-	(50)

* Claims 450
+ Day one loss 100
- Subsequent reversal 50

** 225 Claims reimbursed
+ Day one gain 50
- Subsequent reversal 25

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4. Risk mitigation exception for direct participating contracts

What's the issue?

An insurer may use derivatives to mitigate the financial risks from direct participating contracts issued. The change in the derivatives fair value is recognised in profit or loss under MFRS 9.

To avoid an accounting mismatch, MFRS 17 has a 'risk mitigation exception' that allows an entity to recognise in profit or loss the related change in the insurance contracts value (which would otherwise adjust the CSM under the VFA).

Some reinsurance contracts transfer financial risks from underlying contracts to the reinsurer. An accounting mismatch could arise because entities cannot apply the 'risk mitigation exception', which is only available when a derivative is used to mitigate financial risk.

Change in underlying contract (under the VFA) → **CSM**

Change in reinsurance contract (under the general model) → **Profit or loss and OCI**

What did the Board tentatively decide in January 2019?

To propose to allow an insurer to use the 'risk mitigation exception' when it uses a reinsurance contract held to mitigate financial risk, subject to specific conditions being met.

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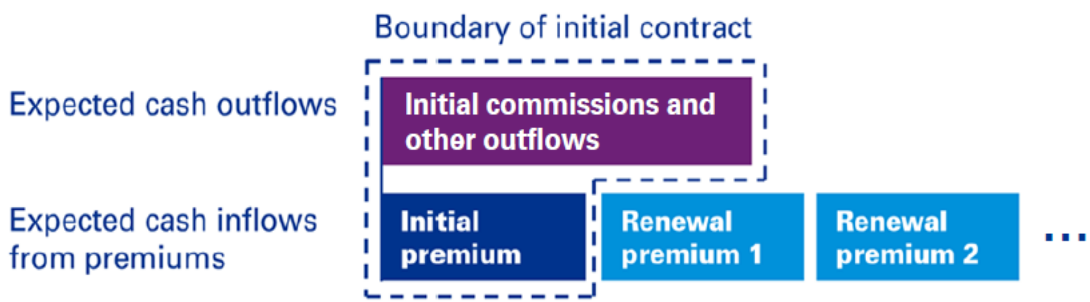
5. Insurance acquisition cash flows for future renewals

What's the issue?

Insurance acquisition cash flows may include commissions paid. Sometimes the commissions exceed the margins to cover such costs embedded in the premium for the initial contract, because the insurer expects to recover some costs from future renewals.

If the commission is non-refundable, it is within the 'contract boundary' of the initial contracts and can cause the contract to become onerous.

A contract rendered onerous by high initial commissions



What did the Board tentatively decide in January 2019?

To propose that insurers would allocate part of the insurance acquisition cash flows directly attributable to newly issued contracts – e.g. initial commissions paid – to expected renewals of contracts outside the contract boundary.

Such cash flows would be recognised as assets until expected renewals are recognised subject to a recoverability test.

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6. Allocating the CSM to investment services under the general model

What's the issue?

Some of the stakeholders believe that some contracts that are not eligible for variable fee approach (VFA) provide investment or other services, and these services should be reflected in the coverage units, which determine the allocation of the CSM to profit or loss.

However, under current MFRS 17 coverage units are determined with reference to insurance service only.

What did the Board tentatively decide in January 2019?

To propose amendments so that the CSM is allocated based on coverage units determined by considering both insurance coverage and any investment return service, a new concept introduced for this amendments.

— An investment return service can exist only where there is an investment component.

— Judgement would be needed to identify such service, and the Board decided not to develop a prescriptive approach to determining when such service is provided.

Basis for determining coverage units

General model	Insurance service + **Investment return service**
VFA	Insurance service + Investment-related service

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7. Scope of MFRS 17 - Loans that transfer significant insurance risk

What's the issue?

Some loans contain a waiver of some or all of the payments due if a future event adversely affects the borrower – e.g. mortgages with a death waiver, student loans and lifetime mortgages.

They are insurance contracts if they transfer significant risk.

Under MFRS 4, entities may have unbundled a loan component and applied IAS 39 to it, but can no longer do so under MFRS 17.

What did the Board tentatively decide in February 2019?

To propose an option to apply either MFRS 17 or MFRS 9 to contracts for which the only insurance is for the settlement of some or all of the obligations created by the contract.

The choice is made irrevocably for each portfolio of contracts as defined in MFRS 17.

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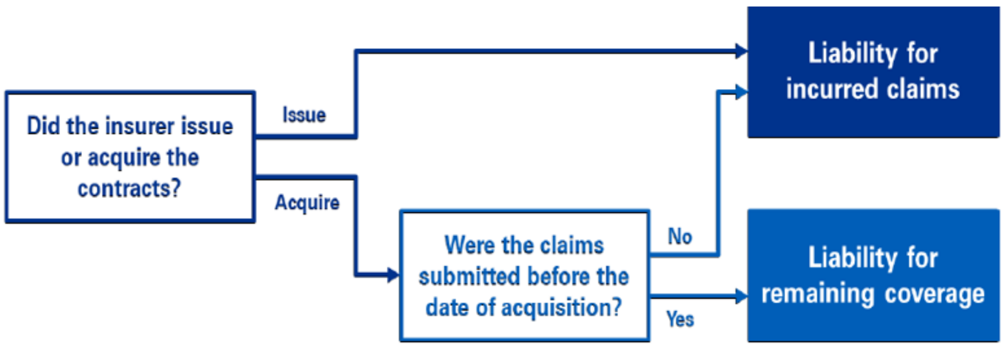
8. Transition

What's the issue?

On transition, an entity may not be able to distinguish between contracts that it issued and those it acquired due to system limitations.



Therefore, it may be impracticable to classify claims on contracts issued as a liability for incurred claims (LIC) and claims acquired as a liability for remaining coverage (LRC).

Stakeholders observed that there was no modifications in the modified retrospective approach for classification of fulfilment cash flows as LIC or LRC, and raised similar concerns for the fair value approach.

What did the Board tentatively decide in February 2019?

To propose to amend the transition requirements for a liability related to settlement of claims incurred before an insurance contract was acquired.

Modified retrospective approach	The entity must classify such liabilities as LIC – to the extent it does not have reasonable and supportable information to apply a retrospective approach.
Fair value approach	The entity may choose to classify such liabilities as LIC or LRC.

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9. Scope exclusion for credit cards that provide insurance coverage

What's the issue?

Some credit card contracts may provide insurance coverage and transfer significant insurance risk.

Since a credit card contract contains both insurance and non-insurance components, this could become a challenge for financial statement preparers because the requirements in MFRS 17 for separating non-insurance components differ from insurance contracts under MFRS 4.

Stakeholders are concerned that card issuers that currently account for a loan or a loan commitment in a credit card contract under MFRS 9 would need to change the accounting for those contracts that transfer significant insurance risk when MFRS 17 becomes effective. This is a short duration after having incurred costs developing a new credit impairment model under MFRS 9.

What did the Board tentatively decide in March 2019?

The Board tentatively decided to amend MFRS 17 to exclude certain credit card contracts that provide insurance coverage from the scope of MFRS 17.

A credit card contract would be eligible for the exclusion if the contract price set by the card issuer for a customer does not reflect an assessment of the insurance risk associated with that individual customer.

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10. Transition requirements- Applying the risk mitigation option

What's the issue?

The risk mitigation option permits insurers to recognize the effect of some changes in financial risk for direct participating contracts in the P/L rather than by adjusting the CSM.

The option is prohibited from being applied for periods before the date of initial application of MFRS 17 because it could involve the use of hindsight.

If risk mitigation activities were in place before initial application of MFRS 17, this prohibition may distort revenue recognized for groups of contracts in future periods and equity on transition.

This results from differences in accounting treatment between insurance contracts and related risk mitigation activities upon transition to MFRS 17.

What did the Board tentatively decide in March 2019?

There are two amendments proposed by the Board:

— Permit the application of the risk mitigation option prospectively from transition date

This allows the accounting mismatch in the comparative period to be eliminated.

— Using the fair value approach(FVA) upon transition even though the insurer can adopt the full retrospective approach

The benefit gained from the better reflection of the insurer's financial risk mitigation outweighs the loss of retrospective information about the insurance contracts.

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11. Disclosures: Insurance acquisition cash flows that relate to future contract renewals

What's the issue?

Under MFRS 17, insurance acquisition cash flows are accounted for by including them in the cash flows expected to fulfil contracts in a group of insurance contracts.

These cash flows may comprise commissions paid for new contracts issued that insurers expect policyholders to renew in the future, sometimes more than once.

In some cases, the commissions may exceed the margins to cover such costs embedded in the premium for the initial contract because the insurer expects to recover some costs from future renewals of that contract.

If the commission is non-refundable, it has to be covered by the premiums within the contract boundary of the newly issued contract under current MFRS 17 when it is initially recognized.

What did the Board tentatively decide in March 2019?

The Board tentatively decided to amend the disclosure requirements in MFRS 17 to reflect their January 2019 proposal.

The March proposal would require insurers to:

- reconcile the asset created by these cash flows at the beginning and the end of the reporting period and its changes, specifically any loss for lack of recoverability or reversals recognized.
- provide quantitative disclosures in appropriate time bands, of when these cash flows are expected to be included in the measurement of the related insurance contracts.

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12. Disclosures: Allocation of the contractual service margin

What's the issue?

Recognition of the CSM in the P/L under the GMM is currently determined by allocating the balance to coverage units, which are determined by assessing the following:

- the quantity of benefits provided under the contracts
- the contracts' expected duration.

Under MFRS 17, for insurance contracts that are not direct participating contracts, the quantity of benefits and contract duration relate only to insurance coverage and do not take into account any investment return services.

What did the Board tentatively decide in March 2019?

The Board tentatively decided to amend the disclosure requirements in MFRS 17, by requiring insurers to provide:

- quantitative disclosures of the expected recognition in the P/L of the CSM remaining at the end of the reporting period
- specific disclosures about their approach to assessing the relative weighting of the benefits provided by **insurance coverage** and **investment-related services** or **investment return services**.

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13. Other key topics discussed - No amendments

Topics discussed	Decision
Optionality of transition requirements There have been concerns raised about the comparability of the insurer's performance due to the different transition approaches available.	The decision has been made not to alter the existing transitional approaches, as the alteration would not meet the criteria set out by the board in the October 2018 meeting. Furthermore, any changes in the transition requirements would disrupt insurers which are already implementing MFRS 17.
Modified retrospective approach - using reasonable and supportable information A proposal has been raised to the board about the removal of 'using reasonable and supportable information' as it is considered to be unclear.	The decision has been made to keep the statement. **Estimates are allowed** under the modified retrospective approach, which it can be regarded as acceptable proxies to full retrospective application.
Modified retrospective approach - specified modifications There have been concerns raised that the modified retrospective approach does not provide sufficient specified modifications.	The decision has been made to keep the specified modifications. The results of applying the **own modification** freely would deviate the modified retrospective approach from the full retrospective approach as per the MFRS 17 requirements.

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13. Other key topics discussed (cont'd)

Topics discussed	Decision
Modified retrospective approach - CSM for direct participating contracts A proposal has been raised to apply specified modifications applicable for non direct participating contracts to direct participating contracts in the CSM determination.	The outcome of this proposal is unlikely to be close to the one that results from the specified modification as per MFRS 17 guidelines for a VFA contract. It is worth noting that the specified modification applicable for the VFA contract is designed such that the CSM can be calculated directly at the transition date.
Retrospective application of risk mitigation is not allowed under MFRS 17 There have been concerns on whether the risk mitigation application can only be used prospectively.	The decision states that it would be difficult to apply the risk mitigation option retrospectively without the use of **hindsight**. Furthermore, it has been noted that hindsight would significantly reduce the value of the information obtained.
Level of aggregation There have been concerns raised that the level of aggregation requirements artificially segregates portfolios and does not depict the business performance accurately.	The decision states that the level of aggregation requirements remains unchanged. This is because any changes made to the existing level of aggregation requirements would result in a loss in fundamental information about trends in an insurer's profit over time.

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14. Next steps

4 Apr 2019

Next TRG meeting

Mid 2019

Exposure draft expected

Amendments would be subject to the Board's normal due process

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