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Project	**Insurance Contracts**		
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Purpose and structure of the paper

1. This paper provides an overview of the main concerns and implementation challenges that have been raised by stakeholders about the requirements in IFRS 17 *Insurance Contracts*.

2. This paper includes some background information and provides for each identified concern or implementation challenge:
   (a) an overview of the IFRS 17 requirements;
   (b) a summary of the Board's rationale for setting those requirements;
   (c) an overview of the concern or implementation challenge expressed; and
   (d) staff preliminary thoughts.

3. This paper should be read in the context of Agenda Paper 2C *Criteria for evaluating possible amendments to IFRS 17*. This paper includes a preliminary assessment against the criteria proposed in Agenda Paper 2C for each topic based on staff preliminary thoughts.

4. The staff note that:
   (a) even if the Board agrees that any potential amendment to IFRS 17 should meet the criteria in paragraph 6 of Agenda Paper 2C, it does not mean that all amendments meeting these criteria are justified.

(b) if the Board were to explore substantive amendments to IFRS 17, this could create uncertainty that could disrupt the progress of preparers in implementing IFRS 17. Paragraphs 165–170 of this paper discuss the date of initial application of IFRS 17.

5. No decisions are requested from the Board. The staff welcome any preliminary views, questions or comments on the concerns and implementation challenges discussed in this paper.

Background

6. The Board issued IFRS 17 on 18 May 2017. IFRS 17 replaces the requirements for accounting for insurance contracts in IFRS 4 *Insurance Contracts* from 1 January 2021.

7. As summarised in Agenda Paper 2 *Cover note*, the Board recognised that IFRS 17 introduces fundamental changes to existing insurance accounting practices for entities that issue insurance contracts. Consequently, the staff and the Board are continuing to undertake significant outreach related to IFRS 17 and are carrying out, and are planning to continue to carry out, activities to support IFRS 17 implementation.

8. As well as assisting those implementing IFRS 17, these activities are helpful for the Board to:

   (a) understand investors' perspectives about the new information they will receive when IFRS 17 is implemented;

   (b) monitor preparers' progress in implementing IFRS 17; and

   (c) assess whether any additional action is needed to address concerns and implementation challenges.

9. The Board asked the staff to provide an overview of the main concerns and implementation challenges about the requirements in IFRS 17 that have been raised since the issuance of the Standard.

Overall comments

10. Different preparers have expressed different concerns and implementation challenges. The importance of the concerns and implementation challenges raised varies significantly by preparer and by jurisdiction.

11. Comments from investors and analysts remain consistent with those presented at the July 2017, February 2018 and May 2018 Board meetings.

12. The following table includes a list of concerns and implementation challenges raised by stakeholders. The topics are listed following the order of the requirements in the Standard.

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1—Scope of IFRS 17 | Loans and other forms of credit that transfer insurance risk

IFRS 17 requirements

13. IFRS 17 applies to all insurance contracts (as defined in IFRS 17), regardless of the type of entity issuing the contracts, with some specific exceptions. The definition of

an insurance contract in IFRS 17 is the same as the definition of an insurance contract in IFRS 4, with clarifications to the related guidance in Appendix B of IFRS 4.[1]

14. Paragraph 7 of IFRS 17 excludes from the scope of the Standard various items that may meet the definition of insurance contracts. Paragraph 8 of IFRS 17 also allows an entity a choice of applying IFRS 17 or IFRS 15 *Revenue from Contracts with Customers* to some fixed-fee service contracts.

15. Under specified circumstances, IFRS 17 requires an entity to:

    (a) separate the non-insurance components from an insurance contract; and

    (b) account for those non-insurance components applying the IFRS Standard that would apply to a separate contract with the same features as the component.

16. IFRS 17 prohibits the separation of non-insurance components from an insurance contract if the specified criteria are not met. IFRS 17 is more restrictive in this regard than IFRS 4.

Board's rationale

17. The Board decided that IFRS 17 should apply to all entities issuing insurance contracts—as opposed to insurers only—because:

    (a) if an insurer that issues an insurance contract accounted for that contract in one way and a non-insurer that issues the same insurance contract accounted for that contract in a different way, comparability across entities would be reduced;

    (b) entities that might meet the definition of an insurer frequently have major activities in other areas as well as in insurance and would need to determine how and to what extent these non-insurance activities would be accounted

[1] The clarifications in IFRS 17 require that: (i) an entity should consider the time value of money in assessing whether the additional benefits payable in any scenario are significant; and (ii) a contract does not transfer significant insurance risk if there is no scenario with commercial substance in which the entity can suffer a loss on a present value basis.

for in a manner similar to insurance activities or in a manner similar to how other entities account for their non-insurance activities; and

(c) a robust definition of an insurer that could be applied consistently from jurisdiction to jurisdiction would be difficult to create.

18. The Board decided to prohibit an entity from separating a non-insurance component when not required to do so by IFRS 17 because:

(a) it would be difficult for an entity to routinely separate components of an insurance contract in a non-arbitrary way, and setting requirements to do so would result in complexity; and

(b) such separation would ignore interdependencies between components, with the result that the sum of the values of the components may not always equal the value of the contract as a whole, even on initial recognition.

19. Therefore, permitting separation of non-distinct non-insurance components would result in less useful information and reduce the comparability of the financial statements across entities.

Concerns and implementation challenges

20. Although the definition of an insurance contract in IFRS 17 is the same as the definition in IFRS 4, stakeholders observed that the requirements in IFRS 17 for the separation of non-insurance components differ from the requirements in IFRS 4.

21. Some stakeholders are concerned that, applying the restrictions on separating non-insurance components in IFRS 17, an entity might be required to account for contracts that transfer significant insurance risk, but that nonetheless include a relatively small insurance component, entirely as insurance contracts. This might be the case for loans and other forms of credit that transfer significant insurance risk.[2] Those contracts may not have the legal form of an insurance contract and may be issued by non-insurance entities.

[2] This could also be the case for some investment contracts with a relatively small insurance component. Some aspects of consequences for such contracts are discussed in paragraphs 79–88 of this paper.

22. A loan contract that transfers significant insurance risk is an insurance contract, as defined by both IFRS 4 and IFRS 17, containing both a loan and an insurance component. Applying IFRS 4, the loan meets the definition of a deposit component in IFRS 4 and may be accounted for separately from the host insurance contract. Applying IFRS 17, the loan does not meet the definition of an investment component, nor can it be accounted for separately.

23. Thus, applying IFRS 4, some entities:

    (a) account separately for insurance and non-insurance components in loan contracts that transfer significant insurance risk; and

    (b) apply IFRS 9 *Financial Instruments* to measure the loan embedded in those contracts.

24. When IFRS 17 is effective those entities will need to apply IFRS 17 to the contract in its entirety.

Staff preliminary thoughts

25. The staff think that it might be possible to amend IFRS 17 to exclude from its scope some or part of insurance contracts that have as their primary purpose the provision of loans or other forms of credit in a way that would:

    (a) avoid significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements—as noted in paragraph 14 of this paper, the scope of IFRS 17 excludes various items that may meet the definition of insurance contracts. Accounting for those contracts, entirely or partially, in the same way as other financial instruments may still provide relevant information to users of financial statements of entities that issue such contracts;[3] and

[3] The staff think this analysis for loans or other forms of credit differs from the analysis of whether investment contracts with a relatively small insurance component should be excluded from IFRS 17.

(b) not unduly disrupt implementation processes that are already under way—many of those contracts are issued by non-insurance entities that may be at a less advanced stage of IFRS 17 implementation.

26. The staff observe that an amendment to the scope of IFRS 17 that results in entities issuing those contracts accounting for them entirely applying IFRS 9 would also require consequential amendments to IFRS 9, IFRS 7 *Financial Instruments: Disclosures* and IAS 32 *Financial Instruments: Presentation*.

2—Level of aggregation of insurance contracts

IFRS 17 requirements

27. An entity can apply the requirements of IFRS 17 to a group of contracts rather than on a contract-by-contract basis. In grouping insurance contracts, an entity is required to identify portfolios of contracts and to divide each portfolio into:

(a) a group of contracts that are onerous at initial recognition, if any;

(b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; and

(c) a group of remaining contracts, if any.

28. A group of contracts cannot include contracts issued more than one year apart.

29. IFRS 17 requires an entity to recognise:

(a) expected losses on onerous groups of contracts immediately in profit or loss; and

(b) expected profits on groups of contracts over the coverage period—by recognising the contractual service margin of a group of contracts in profit or loss as services are provided.

30. Subsequently, the entity is required to remeasure the fulfilment cash flows. Changes in fulfilment cash flows that relate to future service:

(a) are recognised in profit or loss to the extent that they create an onerous group of contracts, or to the extent that they increase or decrease losses of a previously recognised onerous group of contracts; and

(b) adjust the contractual service margin for other groups of contracts.

Board's rationale

31. The level of aggregation at which contracts are recognised and measured is an important factor in the representation of an entity's financial performance.

32. In reaching a decision on the level of aggregation, the Board balanced the loss of information inevitably caused by the aggregation of contracts with the usefulness of the resulting information in depicting the financial performance of an entity's insurance activities, and with the operational burden of collecting the information.

33. The Board considered that it was important to provide timely information about loss-making groups of insurance contracts, consistently with the recognition of losses for onerous contracts in accordance with IFRS 15 and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The Board regarded information about onerous contracts as useful information about an entity's decisions on pricing contracts and about future cash flows and wanted this information to be reported on a timely basis. The Board also thought that grouping contracts that have different likelihoods of becoming onerous reduces the information provided to users of financial statements. Many investors and analysts we spoke to since the issuance of IFRS 17 welcomed that losses on onerous groups of contracts will be recognised when expected because this will:

(a) make visible differences in profitability between different insurance contracts; and.

(b) increase comparability between the profit or loss of insurers and that of entities in other industries.

34. The Board was concerned about the loss of information about the development of profitability over time and profits not being recognised in the correct periods. Therefore, the Board considered restricting the grouping of contracts to those with

similar profitability. However, in response to feedback from preparers on the application of the term ‘similar profitability’, the Board instead introduced the grouping requirements set out in paragraph 27 of this paper and restricted grouping to contracts that are issued within one year of each other as an operational simplification for cost-benefit reasons.

Concerns and implementation challenges

35. Some stakeholders are concerned that the level of aggregation requirements in IFRS 17 are too prescriptive, do not reflect the way risks are managed and might result in excessive granularity, undue costs and complexity.

36. Some stakeholders expressed the view that:

  (a) the requirement to recognise losses on contracts that are onerous on initial recognition may not reflect the level at which pricing decisions are taken and may require costly amendments to systems currently used to link financial data and pricing data.

  (b) identifying contracts that at initial recognition have no significant possibility of becoming onerous subsequently is highly subjective and complex.

  (c) grouping contracts in their entirety—not splitting contracts into different insurance components before applying the level of aggregation requirements—does not reflect the manner in which entities manage their risks and operations in some cases.

  (d) the prohibition to include in a group contracts that are issued more than one year apart may not enable entities to appropriately reflect the effect of cash flows of a group of contracts being affected by cash flows of other groups of contracts as specified in the terms of the contracts. This concern has been raised mainly with reference to insurance contracts with direct participation features.

Staff preliminary thoughts

37. The staff note that one of the main benefits of IFRS 17 is to provide useful information about the profitability of different insurance contracts and how that profitability develops over time. IFRS 17 is expected to make onerous contracts visible in a timely way and to increase comparability between insurers and entities in other industries.

38. The staff think that amending the level of aggregation requirements in IFRS 17—for example, by removing the prohibition to include in a group contracts that are issued more than one year apart or by adding optionality—would cause significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements.

3—Measurement | Acquisition cash flows for renewals outside the contract boundary

IFRS 17 requirements

39. Entities often incur significant costs to sell, underwrite and start insurance contracts (acquisition costs). Insurance contracts are generally priced to recover those costs through premiums or other charges. In some cases, the recovery of those costs is expected during the life of the contract. In other cases, the recovery of those costs will be achieved only if the policyholder renews the contract, sometimes more than once.

40. IFRS 17 requires an entity to recognise insurance acquisition cash flows over the period the entity provides services as an expense and to recognise an amount of revenue equal to the portion of the premium that relates to recovering its insurance acquisition cash flows. IFRS 17 achieves this by requiring that the cash flows from a group of insurance contracts include the acquisition cash outflows or inflows associated with the group of contracts. If insurance acquisition cash flows are paid or received before the related group of insurance contracts is recognised, those cash

flows are recognised as an asset or liability until the group to which those future contracts belong is recognised.[4]

41. The approach in IFRS 17 to acquisition cash flows reduces the contractual service margin on initial recognition of the group of insurance contracts and treats the insurance acquisition cash flows the same as other cash flows incurred in fulfilling contracts. The liability for the group is, at all times, measured as the sum of the fulfilment cash flows, including any expected future insurance acquisition cash flows, and the contractual service margin.

42. Because the contractual service margin can never be less than zero, an entity need not test separately whether it will recover the insurance acquisition cash flows that have occurred but have not yet been recognised as an expense. The measurement model captures any lack of recoverability automatically by remeasuring the fulfilment cash flows. Any insurance acquisition cash flows that cannot be recovered from the cash flows of the portfolio of contracts would reduce the contractual service margin below zero and must therefore be recognised as an expense in profit or loss.

Board's rationale

43. The approach for acquisition cash flows in IFRS 17 results from the Board's view that:

    (a) an entity should not treat insurance acquisition cash flows as a representation of the cost of a recognisable asset because such an asset either does not exist, if the entity recovers insurance acquisition cash flows from premiums already received, or relates to future cash flows that are included in the measurement of the contract.

    (b) by including acquisition cash flows for a group in the fulfilment cash flows of a group, the measurement of the insurance contract is a faithful representation of the obligation to pay for insured losses. That liability does

[4] Unless the entity applying a simplified measurement approach in IFRS 17 to a group of insurance contracts it issues chooses to recognise the acquisition cash flows as expenses or income applying paragraph 59(a) of IFRS 17.

not include the part of the premium intended to compensate for the cost of originating the contracts.

(c) the measurement model in IFRS 17 captures any lack of recoverability of acquisition cash flows for a group of contracts, by remeasuring the fulfilment cash flows of the group.

(d) insurance revenue should not be recognised when insurance acquisition cash flows are paid, often at the beginning of the coverage period because at that time the entity has not satisfied any of the obligations to the policyholder under the contract.

Concerns and implementation challenges

44. Some stakeholders noted that in some cases entities pay insurance acquisition cash flows to sell contracts that are renewable. If the contracts are not renewed amounts paid are not refundable, however economically the amounts paid are viewed as relating to the initial contracts and any renewals. These stakeholders noted that the requirement that acquisition cash flows are included in the measurement of the groups of contracts issued could mean that the contracts are identified as onerous, even if they expect those cash flows to be recovered when those contracts are renewed. They regard that an economic reflection of the transaction would be to allocate those acquisition cash flows to expected renewals of those contracts.

45. Those stakeholders argued that this concern should be addressed by changing the requirements in IFRS 17 either to:

(a) allow cash flows related to future renewals that do not arise from substantive rights and obligations that exist during the reporting period to be included in the measurement of the initial contract issued—this approach would extend the cash flows that are within the contract boundary; or

(b) avoid identifying the initial contracts as onerous— this approach would affect the level of aggregation.

46. Other stakeholders expressed the view that the requirements in IFRS 17 would result in an inconsistent application with other industries when an allocation of the

acquisition costs considers expected future renewals of contracts. Those stakeholders argued that part of the acquisition cash flows for new insurance contracts may relate to anticipated renewals and therefore should not be recognised in profit or loss until the contracts are renewed. Those stakeholders think that:

(a) this outcome could be achieved by recognising part of the insurance acquisition cash flows as an asset and including the amount in the fulfilment cash flows when the contracts are renewed;

(b) such treatment is allowed under IFRS 15 for incremental costs for obtaining a contract; and

(c) IFRS 17 should be amended so that IFRS 15 and IFRS 17 do not result in a different treatment of acquisition cash flows that to some extent relate to anticipated renewals.

Staff preliminary thoughts

47. The staff note that the requirements of IFRS 15 about the treatment of costs related directly to an anticipated contract that the entity can specifically identify[5] cannot be directly compared to the requirements in IFRS 17, mainly for the following reasons:

(a) the scope and definition of acquisition costs under the two Standards differ—IFRS 17 includes a wider range of expenses compared to IFRS 15;

(b) entities issuing insurance contracts typically estimate the renewals of those insurance contracts at a higher level of aggregation, not at an individual contract level as is the case in applying IFRS 15;

(c) the measurement approach required in IFRS 17 is different from IFRS 15, which treats acquisition costs as a representation of the cost of a recognisable asset—the requirement in IFRS 17 to recognise insurance acquisition cash flows as an expense over the coverage period differs from recognising an asset; and

[5] See paragraph 95 of IFRS 15.

(d) applying IFRS 15, contract costs are subject to impairment testing whereas, under IFRS 17, recoverability is dealt with through the remeasurement of the fulfilment cash flows, which automatically results in the recognition of an expense when a group of insurance contracts is onerous.

48. The staff think that amending the IFRS 17 contract boundary requirements to allow cash flows related to future renewals to be reflected in the measurement of the initial contract issued would add complexity to the contract boundary requirements and could result in internal inconsistencies in IFRS 17.

49. In contrast, the staff think that amending IFRS 17 to require or allow an entity to allocate insurance acquisition cash flows directly attributable to a contract not just to that contract, but also to expected renewals of that contract, while inconsistent with the measurement model in IFRS 17:

(a) could still provide useful information for users of financial statements, without unacceptably reducing understandability.

(b) might not unduly disrupt implementation processes that are already under way if entities were allowed, rather than required, to make an allocation. However, the staff note that introducing an option may impair comparability.

4—Measurement | Use of locked-in discount rates to adjust the contractual service margin

IFRS 17 requirements

50. IFRS 17 requires the contractual service margin to be adjusted for changes in estimates of future cash flows that relate to future service. When measuring the fulfilment cash flows, these changes in estimates are measured consistently with all other aspects of the fulfilment cash flows using a current discount rate. For insurance contracts without direct participation features, the adjustment to the contractual

service margin is determined using the discount rate that applies on initial recognition (ie the locked-in discount rate).

51. 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 locked-in discount rate. That difference gives rise to a gain or loss that is included in profit or loss or other comprehensive income (OCI), depending on the accounting policy choice an entity makes for the presentation of insurance finance income or expenses.

Board's rationale

52. The Board decided that the adjustments to the contractual service margin for changes in estimates of future cash flows need to be measured at the rate that applied to the initial determination of the contractual service margin. Making an adjustment measured at the current rate would mean that the contractual service margin would comprise amounts measured at different rates and would have no internal consistency. Measuring the adjustments at a current rate would only be appropriate if the contractual service margin were remeasured to reflect current rates. Such remeasurement occurs under the variable fee approach but would add substantial complexity to the general model.

Concerns and implementation challenges

53. Some stakeholders stated that the gain or loss arising from the difference between the change in the fulfilment cash flows and the adjustment to the contractual service margin described in paragraph 51 of this paper would significantly distort the performance results. This is because they think it is difficult to explain the gain or loss in the statement of financial performance.

54. Other stakeholders noted that differences in the remeasurement of the contractual service margin and of the fulfilment cash flows gives rise to anomalous results.

55. Other stakeholders noted the significantly different outcome between contracts with indirect participation features and those with direct participation features, where the contractual service margin is remeasured.

Staff preliminary thoughts

56. The staff note two possibilities for the rate that should be used to determine the adjustment to the contractual service margin when there is a change in estimates:

    (a) locked-in discount rate approach (IFRS 17 requirements)—the use of a locked-in discount rate means that the contractual service margin, which depicts the unearned profit the entity expects to generate from a group of insurance contracts, is internally consistent. It also means that the effects of changes in discount rate on the difference in estimated cash flows are not included in the contractual service margin and therefore do not affect the insurance service result. This outcome is consistent with the rationale for unlocking the contractual service margin—ie to ensure there is consistency between the unearned profit that is determined on initial recognition of a group and the effect of changes in estimates on that profit—and with the principle in IFRS 17 that the insurance service result is shown separately from the insurance finance income and expenses. It also means that the contractual service margin does not reflect locked-in rates for cash flows expected at initial recognition and different rates for each change in estimate of cash flows.

    (b) current discount rate approach—the use of current discount rates avoids any difference between a change in fulfilment cash flows and a change in the adjustment to the contractual service margin, which some state is difficult to explain. The effect of changes in discount rates on the change in cash flows would be part of the adjustment to the contractual service margin.

57. The staff note that requiring the use of current discount rates for the adjustment to the contractual service margin for changes in future cash flows, rather than locked-in discount rates, would not preserve the consistency discussed in paragraph 56(a) of this

paper and the amount recognised as revenue for the contract would be affected by an arbitrary amount arising from changes in interest rates.

58. The staff also note that under the existing approach in IFRS 17 there are sufficient disclosure requirements around the changes in the contractual service margin and its expected recognition in profit and loss to enable users of financial statements to understand the implications of that existing approach.

59. The staff think that any amendment to the discount rate used to determine the adjustment to the contractual service margin could unduly disrupt implementation processes that are already under way, by requiring some entities to revisit the work they have already done to implement IFRS 17, causing undue costs without a corresponding benefit.

5—Measurement | Subjectivity | Discount rates and risk adjustment

IFRS 17 requirements

60. As with other IFRS Standards, IFRS 17 is principle-based. IFRS 17 requires entities to measure insurance contracts by:

    (a) discounting cash flows using current, market-consistent discount rates that reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts; and

    (b) reflecting the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk (ie a risk adjustment for non-financial risk).

61. IFRS 17:

    (a) permits an entity to determine discount rates and risk adjustment for non-financial risk using different approaches and techniques, as long as they achieve the objectives set out in the Standard; and

    (b) requires the entity to disclose, among others:

(i) information about the approach used to determine discount rate and the risk adjustment for non-financial risk, including the methods and processes used and changes to methods and processes;

(ii) the yield curve (or range of yield curves) used to discount the cash flows that do not vary based on the returns on underlying items; and

(iii) the confidence level used to determine the risk adjustment for non-financial risk or, if the entity uses a technique other than the confidence level technique for determining the risk adjustment for non-financial risk, the technique used and the confidence level corresponding to the results of that technique.

Board's rationale

62. The Board decided on a principle-based approach for determining discount rates and for measuring the risk adjustment for non-financial risk, rather than identifying specific rates or techniques. This approach:

(a) allow entities to develop the best approaches in their circumstances that meet the principles; and

(b) is consistent with the approach used by the Board in developing other IFRS Standards, such as the Board's approach on how to determine a similar risk adjustment for non-financial risk in IFRS 13 *Fair Value Measurement*.

63. The different approaches IFRS 17 allows for determining the discount rates and the risk adjustment for non-financial risk could give rise to different amounts. Accordingly, the Board decided that an entity should disclose information to allow users of financial statements to understand how those amounts might differ from entity to entity.

Concerns and implementation challenges

64. Some investors and analysts we spoke to expressed concerns that the principle-based nature of IFRS 17 could limit comparability between insurance entities. This is because the accounting for insurance contracts relies on assumptions and IFRS 17 requires entities to use judgement to determine key factors for the measurement of insurance contracts, such as the discount rates and the risk adjustment for non-financial risk.

Staff preliminary thoughts

65. The staff think that amending IFRS 17 to prescribe the discount rates used to measure insurance contracts or to limit the number of risk adjustment techniques would conflict with the Board's desire to set principle-based IFRS Standards and might reduce the relevance and faithful representation of the financial statements of entities issuing insurance contracts.

66. Insurance contracts have a variety of forms, terms and conditions. Requiring an entity to measure insurance contracts using a rule-based approach would result in appropriate outcomes only in some circumstances, whereas a principle-based approach allows entities to:

    (a) determine the inputs that are most relevant to the circumstance to provide the information that is most useful to their users of financial statements; and

    (b) provide information in the notes to the financial statements about the methods used and the judgements applied.

67. Importantly, entities applying IFRS 17 are all required to meet the same measurement objectives. IFRS 17 requirements provide a form of comparability without imposing uniformity.

6—Measurement | Risk adjustment in a group of entities

IFRS 17 requirements

68. The measurement of a group of insurance contracts includes a risk adjustment for non-financial risk. The risk adjustment for non-financial risk is defined as 'the compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils insurance contracts'.

69. The risk adjustment for non-financial risk reflects the degree of diversification benefit an entity includes when determining the compensation it requires for bearing that risk.

70. An entity is required to:

    (a) remeasure the risk adjustment for non-financial risk at each reporting date; and

    (b) recognise the risk adjustment for non-financial risk as insurance revenue as the entity is released from risk.

Board's rationale

71. The objective of the risk adjustment for non-financial risk is to reflect the **entity**'s perception of the economic burden of its non-financial risks. IFRS 17 does not specify the level of aggregation at which to determine the risk adjustment for non-financial risk because to do so would contradict with the objective.

72. The entity does not require an explicit separate amount for bearing non-financial risk. Rather, this is implicit within the overall actual amount required by the entity. However, the risk adjustment for non-financial risk represents the compensation that the entity would require if the compensation for bearing non-financial risk were explicit.

Concerns and implementation challenges

73. Some stakeholders are concerned that, when determining the risk adjustment for non-financial risk for contracts issued by an entity in a group structure, the requirements in IFRS 17 could be read in different ways and, therefore, might result in diversity in practice.

74. Some stakeholders read the requirements as requiring the risk adjustment to be determined from the perspective of the entity issuing the contract. The risk adjustment is determined for an individual contract and does not change depending on who is the reporting entity. So, if a subsidiary issues a contract, the risk adjustment is determined by considering what compensation the subsidiary requires as compensation for risk. The risk adjustment is not different in the subsidiary's individual financial statements and the consolidated financial statements, even if the parent might require different compensation for risk for the contracts it issues. The staff think this is what IFRS 17 requires.

75. Some stakeholders read the requirements as requiring or allowing different measurement of the risk adjustment for non-financial risk for a group of insurance contracts at different reporting levels if the issuing entity would require compensation for bearing non-financial risk that differs from that the consolidated group would require.

Staff preliminary thoughts

76. The staff think that amending IFRS 17 to require or allow different measurement of the risk adjustment for non-financial risk for a group of insurance contracts at different reporting levels would add complexity for entities within a group.

77. In contrast, the staff think that amending IFRS 17 to clarify that only the issuing entity that is party to the contract determines the compensation the entity would require for bearing non-financial risk would help entities to apply IFRS 17 in a consistent way and would, therefore, increase comparability—for a group of insurance contracts the risk adjustment for non-financial risk at the consolidated group level would be the same as the risk adjustment for non-financial risk at the individual issuing entity level.

78. However, the staff think that an amendment to IFRS 17 to provide such a clarification might unduly disrupt implementation processes that are already under way. Entities may need to revisit work they have already done to implement IFRS 17, causing undue costs without corresponding benefits.

7—Measurement | Contractual service margin: coverage units in the general model

IFRS 17 requirements

79. IFRS 17 requires an entity to recognise the contractual service margin of a group of insurance contracts over the coverage period of the group. The entity recognises in profit or loss in each period an amount of the contractual service margin for a group of insurance contracts to reflect the profit earned from services provided under the group of insurance contracts in that period. The amount is determined by:

    (a) identifying the coverage units in the group. The number of coverage units in a group is the quantity of coverage provided by the contracts in the group, determined by considering for each contract the quantity of the benefits provided under a contract and its expected coverage duration.

    (b) allocating the contractual service margin at the end of the period (before recognising any amounts in profit or loss to reflect the services provided in the period) equally to each coverage unit provided in the current period and expected to be provided in the future.

    (c) recognising in profit or loss the amount allocated to coverage units provided in the period.

80. At its June 2018 meeting, the Board tentatively decided to propose to clarify the definition of the coverage period for insurance contracts with direct participation features (ie contracts to which the variable fee approach applies) as an Annual Improvement. The proposed amendment would clarify that the coverage period for such contracts includes periods in which the entity provides investment-related services.

Board's rationale

81. The Board views the contractual service margin as depicting the unearned profit for the services the entity provides under insurance contracts. Insurance coverage is the defining service provided by insurance contracts that **do not** include direct participation features. The Board noted that an entity provides this service over the whole of the coverage period, and not just when it incurs a claim. Consequently, IFRS 17 requires the contractual service margin to be recognised over the coverage period in a pattern that reflects the provision of coverage as required by the contract.

82. At its June 2018 meeting, the Board tentatively decided to propose to clarify the definition of the coverage period for contracts to which the variable fee approach applies because:

    (a) for such contracts the existing definition of coverage period is a barrier to the inclusion of periods in which there is no insurance coverage; and

    (b) clarifying the position for variable fee approach contracts will also clarify the position for general model contracts.

83. At the same meeting, the Board did not propose any annual improvement to the definition of coverage period for contracts to which the general model applies because:

    (a) the existing definition is clear: the coverage period for contracts to which the general model applies is the period in which an insured event can occur. Amending the coverage period for variable fee approach contracts so that it includes periods in which investment-related services are provided for those contracts will also emphasise the fact that the coverage period for other contracts includes only the period of insurance coverage.

    (b) the existing definition reflects the Board's thinking when developing the Standard for contracts to which the general model applies: the contractual service margin is recognised over the period that the service of insurance coverage is provided. It is unlikely that any change to the Standard in this regard will provide benefits that outweigh the additional costs and complexity inevitably resulting from such a change.

Concerns and implementation challenges

84. For insurance contracts with investment components to which the general model applies, some stakeholders questioned whether the quantity of benefits includes investment-related services and whether the coverage duration includes periods in which there is no insurance coverage but there are investment-related services.

85. Some stakeholders agree that there is an economic distinction between insurance contracts without direct participation features (to which the general model applies) and insurance contracts with direct participation features (to which the variable fee approach applies). Those stakeholders agree with the outcome of IFRS 17 that:

    (a) for contracts to which the general model applies the quantity of benefits includes only insurance coverage and the contractual service margin is recognised only over the period during which the entity provides coverage for insured events; and

    (b) for contracts to which the variable fee approach applies the coverage period includes periods in which the entity provides investment-related services.

86. Other stakeholders disagree. They believe that some insurance contracts that are not direct participating contracts provide investment-related services and those should be reflected in the coverage units applied for the contractual service margin allocation of those contracts. Some of those stakeholders noted that without amending IFRS 17 to reflect investment-related services in determining coverage units for contracts accounted for under the general model, the application of the requirements would result in unintended consequences. For example:

    (a) contracts that provide insurance coverage for a period significantly shorter than the investment-related services would result in a front-end revenue recognition; and

    (b) deferred annuity contracts with an account balance could result in back-end revenue recognition because insurance services are provided only during the annuity periods.

Staff preliminary thoughts

87. As noted above, at its June 2018 meeting, the Board did not propose any changes to the definition of coverage period for contracts to which the general model applies.

88. The staff are exploring further analysis which might indicate possible amendments to IFRS 17 that could be made without:

   (a) causing significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements; or

   (b) unduly disrupting implementation processes that are already under way.

8—Measurement | Contractual service margin: limited applicability of risk mitigation exception

IFRS 17 requirements

89. A choice is available in IFRS 17 when an entity mitigates the financial risks of insurance contracts with direct participation features using derivatives. The entity may choose to recognise changes in financial risk created by complex features in such insurance contracts, such as minimum payments guaranteed to the policyholder, in profit or loss, instead of adjusting the contractual service margin as normally required by the variable fee approach.

90. IFRS 17 requires prospective application of the risk mitigation option from the date of initial application of the Standard.

Board's rationale

91. The Board's decisions on risk mitigation techniques related to insurance contracts with direct participation features reduce the accounting mismatches that were introduced by the variable fee approach. The Board decided to provide an option to align the overall effect of the variable fee approach more closely to the model for other insurance contracts. However, the Board concluded that it would not be

appropriate to develop a bespoke solution for all hedging activities for insurance contracts, noting that such a solution should form part of a broader project.

92. Consistent with the transition requirements for hedge accounting in IFRS 9, the Board concluded that retrospective application of the risk mitigation treatment would give rise to the risk of hindsight. In particular, the Board was concerned that documentation after the event could enable entities to choose the risk mitigation relationships to which it would apply this option, particularly because the application of this approach is optional. Consequently, IFRS 17, consistent with the transition requirements for hedge accounting in IFRS 9, requires prospective application of the risk mitigation option from the date of initial application of the Standard.

Concerns and implementation challenges

93. Some stakeholders noted that the risk mitigation option applies to insurance contracts with direct participation features only and are concerned that this scope is too narrow. Those stakeholders noted that:

    (a) IFRS 9 requires entities to measure derivatives at fair value with changes entirely recognised in profit or loss; and

    (b) IFRS 17 requires entities issuing insurance contracts without direct participation features to recognise changes in financial assumptions in profit or loss, or disaggregated between profit or loss and OCI.

94. Some stakeholders are concerned that the risk mitigation option can only be used:

    (a) prospectively although hedging arrangements may have been in place before the date of initial application of the Standard; and

    (b) when the hedging instrument is a derivative—those stakeholders believe that the risk mitigation option should be equally applied when reinsurance or other arrangements provide a similar hedging mechanism.

Staff preliminary thoughts

95. The staff note that the Board's objective of reducing accounting mismatches that were introduced by the variable fee approach are achieved through the existing risk mitigation option.

96. The staff think that an amendment to IFRS 17 to extend a deliberately narrow exception from the appropriate accounting for insurance contracts to additional circumstances would cause significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements by increasing complexity and by reducing comparability between entities. Such an amendment would also introduce inconsistencies with, and potentially override the requirements of, IFRS 9.

97. The staff also think that an amendment to IFRS 17 to permit retrospective application of the risk mitigation option would cause significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements, by creating a further inconsistency with IFRS 9. In addition, it may enable entities to 'cherry pick' favourable outcomes for designation and retrospective application.

98. The staff also note that IFRS 9 includes hedge accounting methodologies which can be applied by entities issuing insurance contracts.

9—Measurement | Premium allocation approach: premiums received

IFRS 17 requirements

99. An entity can use a simplified approach to measure some simpler insurance contracts—ie contracts for which the entity does not expect significant changes in estimates before the claims are incurred, or for which the coverage period is a year or less.

100. In the simplified approach, which is referred to as the 'premium allocation approach', an entity measures the liability for remaining coverage as follows:

(a) on initial recognition, the entity measures the liability for remaining coverage at the premiums received under the group of insurance contracts, less any acquisition cash flows paid.

(b) subsequently, as the entity provides coverage, the measurement of the liability for remaining coverage reduces to reflect the coverage provided during the period. In addition, the entity:

   (i) reports as revenue the amount paid by the policyholder for the coverage provided during the period; and

   (ii) accretes interest on the liability.

(c) if a group of contracts is onerous, the entity increases the carrying amount of the liability for remaining coverage to the amount of the fulfilment cash flows.

Board's rationale

101. The Board decided that an entity should be permitted, but not required, to apply the premium allocation approach when that approach provides a reasonable approximation to the general requirements of IFRS 17. The Board views the premium allocation approach as a simplification of those general requirements. Accordingly, an entity applies the level of aggregation requirements when applying the premium allocation approach. The Board's rationale for setting the group of insurance contracts as the unit of account in IFRS 17 is summarised in paragraphs 31–34 of this paper.

Concerns and implementation challenges

102. Stakeholders noted that the receipt of premiums during each reporting period affects the measurement of the liability for remaining coverage of a group of contracts. Accordingly, the requirements in IFRS 17 require entities to identify premiums received for a group of insurance contracts.

103. Consistently with the concerns and implementation challenges expressed about the requirements to present insurance contracts in the statement of financial position (see the discussion in paragraphs 131–138 of this paper), those stakeholders:

(a) noted that a significant implementation challenge results from the need to identify premiums received for each group of contracts; and

(b) suggested to amend the requirements in IFRS 17 for the premium allocation approach to measure insurance contracts at a higher level than a group of contracts (ie no need to identify premiums received for each group of contracts).

Staff preliminary thoughts

104. The staff think that the concerns expressed about the premiums received applying the premium allocation approach are related to the concerns about the level of aggregation requirements in IFRS 17. As discussed in paragraph 38 of this paper the staff think that any possible change to the level of aggregation requirements for measurement purposes would cause significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements.

10—Measurement | Business combinations: classification of contracts

IFRS 17 requirements

105. IFRS 17 amended IFRS 3 *Business Combinations* so that the assessment of whether contracts acquired in a business combination are insurance contracts is made on the basis of terms and conditions at the acquisition date, rather than at the inception of the contract as previously required by IFRS 3.

Board's rationale

106. IFRS 17 amended IFRS 3 by removing an exception to the general classification requirements in IFRS 3 that was introduced for insurance contracts accounted for

applying IFRS 4—an interim Standard. By removing that exception, IFRS 17 introduces consistent accounting for insurance contracts and other contracts in a business combination.

Concerns and implementation challenges

107. Some stakeholders are concerned that the requirement to assess the classification of contracts acquired on the basis of terms and conditions at the acquisition date instead of on the date of their original inception adds complexity and costs and could result in accounting differently for the same contract in different reporting levels in a group of entities. For example, a five-year contract with an investment component providing insurance coverage for the first two years:

    (a) might meet the definition of an insurance contract at its inception date; and

    (b) might not meet the definition of an insurance contract at an acquisition date occurring after the end of Year 2.

Staff preliminary thoughts

108. The staff think that an amendment to IFRS 3 to re-introduce an exception to the general classification requirements in IFRS 3 would cause significant loss of useful information relative to that which would be provided by IFRS 17, by increasing the complexity for users of financial statements and by reducing comparability with the requirements for other transactions.

11—Measurement | Business combinations: contracts acquired during the settlement period

IFRS 17 requirements

109. Paragraph B93 of IFRS 17 requires an entity to identify groups of contracts as if it had entered into the contracts on the acquisition date, assuming the contract meets the definition of an insurance contract at the acquisition date. Paragraph B5 of IFRS 17

states that for insurance contracts that cover events that have already happened, the insured event is the determination of the ultimate cost of those claims. Hence an entity treats insurance contracts in their settlement period acquired in a business combination as providing coverage for the adverse development of claims.

Board's rationale

110. IFRS 17 requirements apply the general principles of business combinations in IFRS 3 to insurance contracts.

Concerns and implementation challenges

111. Some stakeholders noted that applying these requirements reflects a significant change from existing practice and results in implementation challenges and costs. Those stakeholders are concerned that entities would need to apply the general model to contracts acquired in their settlement period (because the period over which claims could develop is longer than one year), while many entities expect to apply the premium allocation approach for similar contracts they issue.

112. In addition, some of those stakeholders expressed the view that users of financial statements could consider the information provided applying the requirements of IFRS 17 to be misleading or counterintuitive because similar contracts will be accounted for differently based on whether they have been issued by the entity or acquired by the entity during their settlement period—contracts acquired in their settlement period will be considered part of the liability for remaining coverage for the entity that acquired the contract and not part of the liability for incurred claims.

Staff preliminary thoughts

113. The staff think that amending IFRS 17 to address the concerns expressed by stakeholders would create inconsistencies in how insurance contracts and other contracts are treated in a business combination.

114. The staff observe that there are other assets and liabilities that are accounted for differently by the entity that hold the assets and liabilities and the acquiring entity after a business combination. As in such cases, additional disclosures might be necessary to provide information that enables users of financial statements to evaluate the nature and financial effect of a business combination according to paragraph 59 of IFRS 3. These disclosures, together with those required by IFRS 17, may mitigate some of the concerns raised above.

12—Measurement | Reinsurance contracts held: initial recognition when underlying insurance contracts are onerous

IFRS 17 requirements

115. IFRS 17 generally requires a reinsurance contract held to be accounted for separately from the underlying insurance contracts to which it relates. However, it requires an entity to recognise some changes in the fulfilment cash flows of a reinsurance contract held in profit or loss, rather than to adjust the contractual service margin, if that change results from a change in the underlying insurance contracts that is recognised in profit or loss.

Board’s rationale

116. In some circumstances, the amount paid by an entity to buy reinsurance contracts does not exceed the expected present value of cash flows generated by the reinsurance contracts held, plus the risk adjustment for non-financial risk. The Board concluded that that amount (ie the apparent gain at initial recognition) represents a reduction in the cost of purchasing reinsurance, and that it would be appropriate for an entity to recognise that reduction in cost over the coverage period as services are received.

117. An entity that holds a reinsurance contract does not normally have a right to reduce the amounts it owes to the underlying policyholder by amounts it expects to receive from the reinsurer. The Board therefore concluded that accounting for a reinsurance contract held separately from the underlying insurance contracts gives a faithful representation of the entity's rights and obligations. The Board noted however that separate accounting for the reinsurance contracts and their underlying insurance contracts under IFRS 17 might create mismatches in the recognition of profit. Consequently, the Board concluded that it was appropriate to recognise changes in reinsurance contracts held that arise from changes in the underlying insurance contracts in the same way, to avoid accounting mismatches.

Concerns and implementation challenges

118. Some stakeholders are concerned that in spite of the fact that IFRS 17 includes an exception for reinsurance contracts that is intended to avoid accounting mismatches, the requirements still give rise to several mismatches and, therefore, may fail to reflect the economic condition of the arrangement being the net risk position. Those stakeholders have identified the following requirements in IFRS 17 as the source of mismatches when a group of insurance contracts is issued and reinsured. An entity issuing a group of onerous contracts is required to recognise:

(a) a loss for this group immediately in profit or loss when expected; and

(b) the gain reflected in a reinsurance contract that exactly mirrors the conditions of the underlying contracts issued over the period that reinsurance services are being provided.

119. These stakeholders also expressed the view that the IFRS 17 requirements for reinsurance contracts held are inconsistent at initial recognition and at a subsequent reporting date. At the reporting date, the carrying amount of the contractual service margin for a group of reinsurance contracts held is adjusted to reflect changes in estimates in the same manner as a group of insurance contracts issued, but with one modification. In some situations, an underlying group of insurance contracts becomes onerous after initial recognition because of adverse changes in estimates of fulfilment

cash flows relating to future service and the entity recognises a loss on the group of underlying contracts. In these situations, for reinsurance contracts held, the modification requires that the corresponding changes in cash inflows would not adjust the contractual service margin of the group of reinsurance contracts held. Instead the effect would be recognised in profit or loss. The result is that the entity recognises no net effect of the loss and gain in the profit or loss for the period to the extent that the change in the fulfilment cash flows of the group of underlying contracts is matched with a change in the fulfilment cash flows on the group of reinsurance contracts held.

Staff preliminary thoughts

120. The staff think that it might be possible to amend IFRS 17 to extend to initial recognition a modification for onerous underlying groups of insurance contracts in a way that would:

(a) avoid significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements—IFRS 17 already provides a mechanism to avoid mismatches of changes in insurance contracts and related reinsurance after initial recognition; and

(b) not unduly disrupt implementation processes that are already under way—many entities holding reinsurance contracts would need to develop systems for recognising losses at initial recognition, as well as for identifying when to recognise in profit or loss a change in the underlying insurance contracts.

13—Measurement | Reinsurance contracts held: ineligibility for the variable fee approach

IFRS 17 requirements

121. IFRS 17 prohibits an entity from applying the variable fee approach to reinsurance contracts it holds.

Board's rationale

122. When an entity purchases a reinsurance contract it aims to transfer a portion of the risks assumed by issuing insurance contracts to another entity (the reinsurer). For reinsurance contracts an entity holds, the entity and the reinsurer do not share in the returns on underlying items, and so reinsurance contracts held do not meet the definition of insurance contracts with direct participation features. This is the case even if the underlying insurance contracts issued are insurance contracts with direct participation features. The Board considered whether it should modify the scope of the variable fee approach to include reinsurance contracts held, if the underlying insurance contracts issued are insurance contracts with direct participation features. But such an approach would be inconsistent with the Board's view that a reinsurance contract held should be accounted for separately from the underlying contracts issued.

Concerns and implementation challenges

123. Some stakeholders are concerned that the prohibition for an entity to apply the variable fee approach to reinsurance contracts it holds may give rise to mismatches they regard as accounting mismatches. The resulting accounting therefore fails to reflect the economics of the arrangement being a net risk position.

Staff preliminary thoughts

124. The requirements of the variable fee approach were developed to give a faithful representation of insurance contracts that are substantially investment-related service contracts. The scope of the variable fee approach was set to identify such contracts. The staff think that amending IFRS 17 to make reinsurance contracts held eligible for the variable fee approach would result in the approach being applied to contracts for which it was not developed and is not suited and would, therefore, reduce the usefulness of the information provided.

14—Measurement | Reinsurance contracts held: expected cash flows arising from underlying insurance contracts not yet issued

IFRS 17 requirements

125. An entity should apply the contract boundary requirements in paragraph 34 of IFRS 17 to the reinsurance contracts it holds. This means that cash flows within the boundary of a reinsurance contract held arise from the substantive right to receive services from the reinsurer and the substantive obligation to pay amounts to the reinsurer. A substantive right to receive services from the reinsurer ends when the reinsurer has the practical ability to reassess the risks transferred to the reinsurer and can set a price or level of benefits for the contract to fully reflect the reassessed risk or the reinsurer has a substantive right to terminate the coverage.

126. Accordingly, cash flows within the boundary of a reinsurance contract held could include cash flows from underlying contracts covered by the reinsurance contract that are expected to be issued in the future.

Board's rationale

127. Insurance contracts issued and reinsurance contracts held are measured applying the same measurement model—the measurement includes an estimate of all the future cash flows within the contract boundary. As a result, the cash flows used to measure the reinsurance contracts held reflect the cash flows of the underlying contracts that the reinsurance contract held covers.

Concerns and implementation challenges

128. Some stakeholders are concerned that the contract boundary requirements in IFRS 17 will result in operational complexity. This is because they introduce a change to most existing accounting practices for reinsurance contracts held, such as the need to

include, in the contract boundary of those contracts, cash flows related to underlying insurance contracts yet to be issued. Those stakeholders expressed the view that:

(a) there would be inconsistent cash flows included within the contract boundaries of reinsurance contracts held and those within the contract boundary of the underlying insurance contracts; and

(b) contract boundary requirements in IFRS 17 will be difficult to apply in practice in particular for the underlying contracts that have yet to be issued.

Staff preliminary thoughts

129. The staff think that amending the IFRS 17 contract boundary requirements would result in internal inconsistencies in IFRS 17 because it would require entities to ignore rights and obligations arising from the reinsurance contract. It would also introduce inconsistencies between rights and obligations recognised by the reinsurer and those recognised by the cedant.

130. Consistently with what is noted in paragraph 48 of this paper, the staff also think that amending the IFRS 17 contract boundary requirements would add complexity to the contract boundary requirements.

15—Presentation in the statement of financial position | Separate presentation of groups of assets and groups of liabilities

IFRS 17 requirements

131. IFRS 17:

(a) requires an entity to present the combination of rights and obligations arising from a group of insurance contracts as a single asset or liability for insurance contracts in the statement of financial position; and

(b) prohibits the entity from offsetting groups of insurance contracts in an asset position with groups of insurance contracts in a liability position.

Board's rationale

132. A group of insurance contracts is the unit of account applying IFRS 17. The *Conceptual Framework for Financial Reporting* states:

> The unit of account is the right or the group of rights, the obligation or the group of obligations, or the group of rights and obligations, to which recognition criteria and measurement concepts are applied.
>
> Offsetting occurs when an entity recognises and measures both an asset and liability as separate units of account, but groups them into a single net amount in the statement of financial position. Offsetting classifies dissimilar items together and therefore is generally not appropriate.
>
> Offsetting assets and liabilities differs from treating a set of rights and obligations as a single unit of account.

133. Consistent with the *Conceptual Framework* and with the requirement in IAS 1 *Presentation of Financial Statements* that an entity not offset assets and liabilities, IFRS 17 prohibits entities from offsetting groups of insurance contracts in an asset position with groups of insurance contracts in a liability position.

Concerns and implementation challenges

134. Some stakeholders stated that a significant implementation challenge resulting from IFRS 17 requirements for the presentation in the statement of financial position is the need to allocate cash flows to each group of insurance contracts to determine if a group of insurance contracts is in an asset or in a liability position. Those stakeholders observed that applying many existing insurance accounting practices, line items of the statement of financial position reflect a relatively high level of aggregation of insurance contracts (for example, at an entity level). However, they are disaggregated in a manner that is consistent with the way that entities manage their operations and systems.

135. Those stakeholders are concerned that to allocate cash flows to each group of contracts, they need to develop new systems to identify premiums received, claims incurred and other separately managed presented balances for each group of contracts. Such development is likely to be complex and costly. Consequently, those stakeholders questioned whether the usefulness of the information that the presentation requirements in IFRS 17 will provide to the users of financial statements is sufficient to justify such costs.

136. A few stakeholders suggested that IFRS 17 should be amended to require aggregation at a portfolio or entity level for presentation purposes.

Staff preliminary thoughts

137. The staff observe that offsetting generally does not meet the objective of financial reporting as set out in the *Conceptual Framework*.[6] Presenting items on a net basis might:

    (a) obscure the existence of some transactions and change the size of the financial statements of an entity; and

    (b) detract from the ability of users of financial statements to understand the transactions and to assess an entity's future cash flows, except when offsetting reflects the substance of the transaction or other event.

138. However, the staff think that it might be possible to amend IFRS 17 to enable entities to offset groups of insurance contracts that are in a liability position with groups of insurance contracts that are in an asset position in a way that would:

    (a) avoid significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements—to limit the possible loss of useful information, the staff think that IFRS 17 could be amended to permit offsetting only at portfolio level, rather than at an entity level; and

[6] The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity.

(b) not unduly disrupt implementation processes that are already under way—the staff have been told that such amendment might significantly reduce implementation costs for many entities. This possible reduction of costs needs to be assessed against the potential loss of useful information mentioned in paragraph 138(a).

16—Presentation in the statement of financial position | Premiums receivable

IFRS 17 requirements

139. IFRS 17 requires an entity to measure a group of insurance contracts including all the cash flows expected to result from the contracts in the group, including premiums receivable.

Board's rationale

140. This requirement is consistent with the requirements for the measurement of insurance contracts to include all expected cash flows and with the requirements not to separate out specific components.

Concerns and implementation challenges

141. Some stakeholders noted that the requirement to measure a group of insurance contracts including premiums receivable represents a significant change from existing insurance accounting practices and are concerned that this requirement will involve significant implementation costs, particularly for short-term contracts.

142. Many entities currently account for premiums receivable as financial assets applying IFRS 9. In most cases, information about premiums receivable is produced by cash management or credit management systems that are not linked to policy administration systems and actuarial valuation systems. As noted in paragraph 134 of this paper, some stakeholders observed that applying many existing insurance accounting practices, line items of the statement of financial position, including

premiums receivable, reflect a relatively high level of aggregation of insurance contracts (for example, at an entity level).

Staff preliminary thoughts

143. The staff think that amending IFRS 17 to measure and present premiums receivable separately from insurance contracts would:

(a) result in internal inconsistencies in IFRS 17—IFRS 17 model recognises that contracts, and by extension groups of contracts, create a single bundle of rights and obligations. Measuring premiums receivable separately from the corresponding obligations is inconsistent with this model; and

(b) reduce comparability between entities—the staff understand that systems currently used by entities recognise premiums receivable over different periods, for example, one entity may only recognise premiums due in the current month that were not yet received, while another entity may reflect premiums due in the next 12 months in premiums receivable.

144. Therefore, the staff think that such amendment to IFRS 17 would cause significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements.

145. However, the staff note that the concerns and implementation challenges raised in paragraphs 141 and 142 of this paper might be resolved to some extent if the Board were to amend IFRS 17 as discussed in paragraph 138 of this paper. The staff also note that entities could continue to disclose this information if in their view it is useful to the users of their financial statements.

17—Presentation in the statement(s) of financial performance | OCI option for insurance finance income or expenses

IFRS 17 requirements

146. IFRS 17 permits an entity to choose to present insurance finance income or expenses either in profit or loss or disaggregated between profit or loss and OCI.

Board's rationale

147. The Board considered requiring entities to include all insurance finance income or expenses in profit or loss. This would prevent accounting mismatches with finance income from assets measured at fair value through profit or loss, and could also reduce the complexity inherent in disaggregating changes in the liability. However, many stakeholders expressed concern that gains and losses from underwriting and investing activities would be obscured by more volatile gains and losses arising from changes in the current discount rate applied to the cash flows in insurance contracts. In addition, many preparers of financial statements expressed concern that they would be forced to measure their financial assets at fair value through profit or loss to avoid accounting mismatches. These preparers noted that the Board has indicated that amortised cost and fair value through OCI are appropriate measures for financial assets in some circumstances and that IFRS 9 would generally require an entity to measure financial liabilities at amortised cost. Accordingly, these preparers say that the volatility in profit or loss that would result from a current value measurement of insurance contracts would impair the faithful representation of their financial performance and users of financial statements would face difficulties in comparing insurers with entities that have no significant insurance contracts. The Board was not persuaded that entities that issue insurance contracts would be disadvantaged if insurance contracts were to be measured at current value. However, the Board was persuaded that users of financial statements may find that, for some contracts, the presentation of insurance finance income or expenses based on a systematic allocation

in profit or loss would be more useful than the presentation of total insurance finance income or expenses in profit or loss.

148. The Board also considered requiring all insurance finance income or expenses to be included in profit or loss with separate presentation of some or all such income or expenses. Such presentation would provide disaggregated information about the effects of changes in insurance contract assets and liabilities in profit or loss. However, the Board rejected this approach for the same reasons given in the preceding paragraph and also because it would introduce operational complexity.

Concerns and implementation challenges

149. Most investors and analysts we spoke to expressed concerns that permitting, but not requiring, a presentation of the effect of some changes in financial assumptions in OCI could impair comparability between entities.

150. IFRS 17 requires an entity that chooses to disaggregate insurance finance income or expenses between profit or loss and OCI to disclose an explanation of the methods used to determine the amounts recognised in profit or loss. Hence IFRS 17 provides users of financial statements with a basis to adjust information reported by entities to make them more comparable. However, some expressed the view that this option adds unnecessary complexity to their analysis of the information reported by entities in applying IFRS 17.

Staff preliminary thoughts

151. The staff think that amending IFRS 17 to require entities to present insurance finance income or expenses either entirely in profit or loss or partly in OCI would increase comparability between entities. However, the staff believe that such an amendment would unduly disrupt implementation processes that are already under way. Entities may need to revisit work they have already done to implement IFRS 17, causing undue costs without corresponding benefits.

18—Defined terms | Insurance contract with direct participation features

IFRS 17 requirements

152. IFRS 17 distinguishes between insurance contracts with and without direct participation features. The general model is modified for insurance contracts with direct participation features—those contracts are measured applying modified requirements referred to as the 'variable fee approach'.

153. Insurance contracts with direct participation features are insurance contracts for which, on inception:

    (a) the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items;

    (b) the entity expects to pay to the policyholder an amount equal to a substantial share of the fair value returns from the underlying items; and

    (c) 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.

154. IFRS 17 requires the contractual service margin for insurance contracts with direct participation features to be updated for more changes than those affecting the contractual service margin for other insurance contracts. In addition to the adjustments made for other insurance contracts, the contractual service margin for insurance contracts with direct participation features is also adjusted for the effect of changes in:

    (a) the entity's share of the underlying items; and

    (b) financial risks other than those arising from the underlying items, for example the effect of financial guarantees.

155. As noted in paragraph 80 of this paper, at its June 2018 meeting, the Board tentatively decided to propose to clarify that the coverage period for insurance contracts with direct participation features includes periods in which the entity provides investment-related services. Accordingly, for those contracts the contractual service margin is

recognised over the period when both investment-related services and insurance services are provided.

Board's rationale

156. The Board decided that these differences are necessary to give a faithful representation of the different nature of the service provided in these contracts.

157. The Board used specific conditions to define insurance contracts with direct participation features. The Board also decided that an entity need not hold the underlying items, because the measurement of insurance contracts should not depend on what assets the entity holds.

Concerns and implementation challenges

158. Some stakeholders are concerned that the scope of the variable fee approach is too narrow resulting in economically similar contracts being accounted for differently. In their view some types of insurance contracts are economically similar to insurance contracts with direct participation features except that:

    (a) the relationship between investments and the insurance contract arise from a constructive rather than contractual obligation; and

    (b) the contractual terms do not specify a clearly identified pool of underlying items.

159. Those stakeholders expressed the view that specifying different accounting for insurance contracts with direct participation features and for insurance contracts without direct participation features results in differences because coverage units in the general model do not reflect investment-related services (see paragraphs 79–88 of this paper for a discussion of this specific concern).

Staff preliminary thoughts

160. The staff think that amending the scope of the variable fee approach would not address the concerns expressed by stakeholders about differences in accounting between insurance contracts accounted for applying the general model and insurance contracts accounted for applying the variable fee approach. Whatever scope was set, there would be differences between the accounting for contracts within the scope and those outside the scope. The requirements of the variable fee approach were developed to give a faithful representation of insurance contracts that are substantially investment-related service contracts and the scope of the variable fee approach was set to identify such contracts.

19—Interim financial statements | Treatment of accounting estimates

IFRS 17 requirements

161. Notwithstanding the requirement in IAS 34 *Interim Financial Reporting* that the frequency of reporting shall not affect the measurement of the annual results, IFRS 17 requires that entities do not change the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements or in the annual financial statements.

Board's rationale

162. Requiring the contractual service margin to be adjusted for changes in estimates of the fulfilment cash flows but not for experience adjustments has the consequence that the accounting depends on the timing of a reporting date. Applying the requirements of IAS 34 would have required the recalculation of previously reported amounts at each subsequent interim reporting period and in the annual financial statements. The Board therefore decided that IFRS 17 should specifically prohibit entities from changing the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent interim financial statements or in the annual financial statements.

Concerns and implementation challenges

163. The requirements of IFRS 17 are applicable to interim financial reports as defined in IAS 34. Some stakeholders believe that this requirement should be extended to other types of interim reports, such as monthly management reports or internal reports provided by subsidiaries to a parent entity. These stakeholders observed that applying IFRS 17 requirements raise practical concerns as entities may need to maintain two sets of reports given the other types of reports would not meet the requirements of IFRS 17.

Staff preliminary thoughts

164. The staff think that extending the requirements to any type of reporting that is not defined elsewhere in IFRS Standards would add complexity for both preparers and users of financial statements. In addition, it would result in a significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements because it would reduce comparability among entities.

20—Effective date | Date of initial application of IFRS 17

IFRS 17 requirements

165. An entity is required to apply IFRS 17 for annual periods beginning on or after 1 January 2021. An entity can choose to apply IFRS 17 before that date but only if it also applies IFRS 9 and IFRS 15.

Board's rationale

166. The Board set the effective date for IFRS 17 based on information given about the necessary time to prepare, in the knowledge that restated comparative information for one reporting period would be required. The Board allowed a period of three and a half years from the issuance of IFRS 17 to its mandatory effective date.

167. The Board generally allows at least 12 to 18 months between the publication of a new Standard and its mandatory effective date. However, in the case of major Standards, such as IFRS 17, that have a pervasive effect on entities, the Board has allowed longer implementation periods to allow entities time to resolve the operational challenges in implementing those Standards. At the same time, the Board needs to balance the advantage of a longer implementation period for preparers against the disadvantages of allowing inferior accounting practices, arising from IFRS 4, to continue.

168. While the Board noted that this long implementation period may assist entities in meeting any increased regulatory capital requirements that follow the reporting of the higher liabilities that are expected in some jurisdictions, regulatory capital requirements and IFRS Standards have different objectives. The Board decided that the possible effects of regulatory capital requirements should not delay the implementation of a Standard intended to provide transparency about an entity's financial position.

Concerns and implementation challenges

169. Some stakeholders expressed the view that there is insufficient time to implement IFRS 17 before its effective date. Some stakeholders suggested that the Board should postpone the effective date of IFRS 17, by one, two or three years, for the following reasons:

(a) entities need more time to prepare than they originally expected.

(b) potential delays to the European Union endorsement process might mean that entities around the world will not initially apply IFRS 17 at the same time.

(c) a successful implementation of IFRS 17 requires dependence on internal or third party experts, particularly actuaries and IT systems providers. Some stakeholders are concerned that limitations in the availability of those resources will make it difficult for them to implement IFRS 17 on time.

(d) there is insufficient lead time for some stakeholders to inform and prepare investors, analysts and other users of financial statements about the significant changes in reported information that will arise from the implementation of IFRS 17.

(e) other elements, outside the control of entities, relating to resources, education, operational change management, regulatory capital and supervision, and taxation, might not be realistically complete before 1 January 2021.

Staff preliminary thoughts

170. The staff note that deferring the effective date of IFRS 17 would defer the benefits that it will introduce, but not change the benefits themselves. The staff observe that the extent of disruption to implementation depends on the period of any deferral and many stakeholders have told us that it would be useful (such as for planning and budgeting purposes) to understand sooner rather than later if the Board were to amend the effective date of IFRS 17. Many stakeholders think that a one-year deferral would be helpful. However, some stakeholders expressed concerns that deferring the Standard further could increase costs, without a corresponding benefit. For example, some entities might interrupt implementation processes that are already under way, or suffer from a deprioritisation or removal of resources allocated to those implementation processes. Some stakeholders noted their experience of changing effective dates when implementing regulatory changes demonstrated that deferring effective dates can increase costs.

21—Effective date | Comparative information

IFRS 17 requirements

171. On first application of IFRS 17, an entity is required to restate comparative information about insurance contracts for one year. IFRS 17 permits, but does not

require, an entity to present adjusted comparative information applying IFRS 17 for any earlier periods presented.

172. An entity is permitted, but not required, to restate comparative information applying IFRS 9 if it is possible without hindsight.

Board's rationale

173. The Board concluded that not restating comparative information about insurance contracts reduces the usefulness of financial statements on initial application of IFRS 17 and hinders the assessment of the effects of applying IFRS 17 for the first time. Comparatives are particularly important because:

(a) IFRS 17 introduces fundamental changes to the accounting for insurance contracts, which are currently subject to the wide range of accounting practices entities apply under IFRS 4; and

(b) the effects are so pervasive on the financial statements of insurers.

174. The Board considered the disadvantages of non-aligned accounting for financial assets and insurance contracts in the comparative period, but concluded that an entity can avoid accounting mismatches as it is permitted, but not required, to restate comparative information applying IFRS 9 if it is possible without hindsight (either when the entity applies IFRS 9 and IFRS 17 for the first time in the same annual period or it has previously applied IFRS 9 and chooses to apply transition reliefs for financial assets).

Concerns and implementation challenges

175. Some stakeholders suggested that the Board can address the concerns expressed about the effective date by permitting entities not to present adjusted comparative information when applying IFRS 17.

176. Some stakeholders are concerned that financial statements that restate comparative information about insurance contracts, but not about financial assets, could distort users' understanding of those entities' economic circumstances and transactions both

in prior periods and the current period. This is because the comparative period might show accounting mismatches between insurance contracts and related financial assets, and the net financial position and profit reported by entities in the comparative period would not be comparable to that reported in the current reporting period.

177. Some stakeholders also noted the different approach to restating comparative information applying the transition requirements of IFRS 9.

Staff preliminary thoughts

178. The staff think that amending IFRS 17 to permit entities not to present adjusted comparative information when first applying IFRS 17 would increase the complexity for users of financial statements and, therefore, would cause significant loss of useful information relative to that which would be provided by IFRS 17. Investors and analysts we spoke to since the issuance of the Standard have already noted how difficult it will be to understand the transition to IFRS 17 in the light of the options available on transition (see discussion on paragraph 189–195 of this paper). Permitting entities not to present adjusted comparative information when first applying IFRS 17 would add to this issue.

22—Effective date | Temporary exemption from applying IFRS 9

IFRS 17 requirements

179. IFRS 4 as amended in September 2016 addresses the temporary accounting consequences of the different effective dates of IFRS 9 and IFRS 17. IFRS 4 permits:

(a) entities whose predominant activities are connected with insurance to defer the application of IFRS 9 until 2021; and

(b) all issuers of insurance contracts to recognise in OCI, rather than profit or loss, the volatility that could arise when IFRS 9 is applied before IFRS 17 (overlay approach).

Board's rationale

180. The Board observed that although the overlay approach addressed concerns about the additional accounting mismatches and volatility in profit or loss that may arise when IFRS 9 is applied in conjunction with IFRS 4, it would result in additional costs compared to applying IFRS 9 without the overlay approach or allowing insurers to continue to apply IAS 39 *Financial instruments: recognition and measurement*.

181. Accordingly, the Board introduced a temporary exemption from IFRS 9 for a limited period for insurers whose activities are predominantly connected with insurance. An insurer applying the temporary exemption continues to apply IAS 39 rather than applying IFRS 9. The Board concluded that, for such insurers in that limited period, the temporary exemption reduces costs in a way that would outweigh the following disadvantages:

    (a) users of financial statements would not have the significantly improved information about financial instruments provided by applying IFRS 9; and

    (b) cross-sector comparability would be reduced.

182. IFRS 17 replaces IFRS 4 and, therefore, the temporary exemption from IFRS 9 will no longer exist when the insurer first applies IFRS 17. However, the Board decided that, even if IFRS 17 is not effective by 1 January 2021, all insurers must apply IFRS 9 for annual periods beginning on or after 1 January 2021.

183. The Board considered the view that an insurer should be required to apply IFRS 9 only when it applies IFRS 17. However, the Board disagreed with that view because IFRS 9 provides significant improvements to the accounting requirements for financial instruments. Hence, the Board decided that a temporary exemption from IFRS 9 would be acceptable only if it is in place for a short period of time. Therefore, insurers are required to apply IFRS 9 no later than 2021.

184. In contrast, the Board rejected a fixed expiry date for the overlay approach. Unlike insurers applying the temporary exemption from IFRS 9, insurers applying the overlay approach will provide the improved financial instrument information required by IFRS 9 and information about the effects on designated assets of moving from

IAS 39 to IFRS 9. IFRS 17 replaces IFRS 4 and, therefore, the overlay approach in IFRS 4 will no longer exist when the insurer first applies IFRS 17.

185. Although creating options within IFRS Standards can reduce comparability, the Board made both the overlay approach and the temporary exemption from IFRS 9 optional. This permits insurers that are eligible for the temporary exemption from IFRS 9 or the overlay approach to choose not to apply them and instead apply the improved accounting requirements in IFRS 9 without adjustment.

Concerns and implementation challenges

186. Some stakeholders are concerned that if the Board were to defer the mandatory effective date of IFRS 17, preparers and users of financial statements will experience two sets of major accounting changes in a short period of time resulting in significant cost and effort for preparers and users of financial statements. Those stakeholders suggested that if the Board were to defer the mandatory effective date of IFRS 17, the Board should also revise the fixed expiry date of the temporary exemption from IFRS 9 in IFRS 4 to allow entities to continue applying the temporary exemption from IFRS 9 until the newly determined effective date of IFRS 17.

Staff preliminary thoughts

187. The staff note that the effective date of IFRS 9 for entities whose predominant activities are connected with insurance does not affect the benefits arising from IFRS 17 requirements. However, it does affect the usefulness of information that is provided to users of financial statements about the financial instruments those entities hold.

188. The staff also note that entities applying the temporary exemption from applying IFRS 9 will be applying IFRS 9 up to three years after other entities. If the Board were to defer the effective date of IFRS 17 by one year and extend the temporary exemption from applying IFRS 9 at the same time, then some entities would be permitted not to apply IFRS 9 up to four years after other entities—ie potentially eight

years after IFRS 9 was issued. A further delay might result in a loss of useful information because it would:

(a) increase the risk of complexity and confusion for users of financial statements because of the continuing existence and use of different accounting standards for the same underlying instruments; and

(b) extend the period over which:

  (i) the effect of market changes or disruptions would be reflected differently depending on which Standard is being applied; and

  (ii) poorer quality information about expected credit losses is provided by insurers who are significant holders of financial assets.

23—Transition | Optionality

IFRS 17 requirements

189. An entity should apply IFRS 17 retrospectively. If a full retrospective application is impracticable, an entity can choose—on a group-by-group basis—between:

(a) a modified retrospective approach, that aims to approximate the outcome of a retrospective application of IFRS 17 provided that reasonable and supportable information is available; and

(b) a fair value approach.

Board's rationale

190. Consistent with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, which requires retrospective application of a new accounting policy except when it would be impracticable, the Board concluded that entities should apply IFRS 17 retrospectively and should be allowed to use alternatives only when retrospective application of IFRS 17 is impracticable.

191. The Board acknowledged a choice of transition methods results in a lack of comparability of transition amounts but concluded it was appropriate because:

(a) the similarity between a modified retrospective approach and a full retrospective application would depend on the amount of reasonable and supportable information available to an entity; and

(b) if an entity has relatively little reasonable and supportable information available, and, therefore, would need to use many of the permitted modifications, the cost of the modified retrospective approach might exceed the benefits.

192. The Board expects that there will be some differences in the measurement of insurance contracts when applying the different transition approaches permitted in IFRS 17. Accordingly, the Board decided to require that an entity provides disclosures that enable users of financial statements to identify the effect of groups of insurance contracts measured at the transition date applying the modified retrospective approach or the fair value approach on the contractual service margin and revenue in subsequent periods. Furthermore, the Board decided that entities should explain how they determined the measurement of insurance contracts that existed at the transition date for all periods in which these disclosures are required, for users of financial statements to understand the nature and significance of the methods used and judgements applied.

Concerns and implementation challenges

193. Some stakeholders are concerned that the availability of the transition options and the optionality embedded in applying them could reduce comparability of the entities' performance going forward, potentially for a number of years.

194. Most investors and analysts we spoke to agreed with the Board's conclusion that retrospective application of IFRS 17 provides the most useful information by allowing comparison between contracts written before and after the date of transition. Those investors and analysts were therefore concerned that the use of alternative transition methods could result in a loss of trend information for some groups of insurance

contracts. Many were pleased to learn that entities will be required to separately disclose the ‘transition contractual service margin’ in subsequent periods and agreed that this disclosure requirement could be a mitigating factor that is helpful in their future analysis.

Staff preliminary thoughts

195. The staff think that amending IFRS 17 to require entities to use only one transition approach—such as the fair value approach that entities would be able to apply to all insurance contracts they issue—would not cause significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements and would, instead, increase the comparability of financial information of entities applying IFRS 17. However, the staff think that such a change to IFRS 17 transition requirements would unduly disrupt implementation processes that are already under way and may increase implementation costs for entities.

24—Transition | Modified retrospective approach: further modifications

IFRS 17 requirements

196. If a full retrospective application of IFRS 17 is impracticable, an entity can apply a modified retrospective approach as an alternative transition method to determine the contractual service margin for groups of contracts in force at the date of transition.

197. IFRS 17 specifies the modifications available to entities if retrospective application of IFRS 17 is impracticable.

Board’s rationale

198. The Board decided to specify some modifications that could be applied if retrospective application is impracticable, to address the fact that measuring the following amounts would often be impracticable:

(a) the estimates of cash flows at the date of initial recognition;

(b) the risk adjustment for non-financial risk at the date of initial recognition;

(c) the changes in estimates that would have been recognised in profit or loss for each accounting period because they did not relate to future service, and the extent to which changes in the fulfilment cash flows would have been allocated to the loss component;

(d) the discount rates at the date of initial recognition; and

(e) the effect of changes in discount rates on estimates of future cash flows for contracts for which changes in financial assumptions have a substantial effect on the amounts paid to policyholders.

Concerns and implementation challenges

199. Some stakeholders are concerned that the modified retrospective approach does not provide sufficient modifications to allow the approach to be practicable to apply in practice. Some would like the approach to be more principle based or to allow for more modifications to be applied.

200. Some stakeholders noted that if the Board does not amend the modified retrospective approach, then the fair value approach to transition would have to be applied and noted their concerns around the potential impact of applying this approach on profit recognition patterns in some situations. Some stakeholders are concerned that applying the fair value approach to transition would reflect a performance that is inconsistent with past performance because the approach is forward looking.

Staff preliminary thoughts

201. The staff think that it might be possible to amend the requirements in IFRS 17 for the modified retrospective approach by introducing additional modifications in a way that would:

(a) avoid significant loss of useful information relative to that which would be provided by IFRS 17 for users of financial statements —IFRS 17 already provides some modifications that can be used when full retrospective application of IFRS 17 is impracticable and minor amendments and clarifications to those modification might be made without unacceptably decreasing comparability; and

(b) not unduly disrupt implementation processes that are already under way — any additional modifications to the transition approach might simplify the initial application of IFRS 17 for some entities.

25—Transition | Fair value approach: OCI on related financial assets

IFRS 17 requirements

202. If a full retrospective application of IFRS 17 is impracticable, an entity can apply a fair value approach as an alternative transition method to determine the contractual service margin for groups of contracts in force at the date of transition.

203. In applying the fair value approach, the entity:

(a) determines the contractual service margin at the transition date as the difference between the fulfilment cash flows and the fair value of the group of insurance contracts, determined in accordance with IFRS 13; and

(b) can use the same modifications as the modified retrospective approach relating to:

(i) assessments about insurance contracts or groups of insurance contracts that would be made at the date of inception or initial recognition; and

(ii) determining the discount rates and the effect of changes in discount rates necessary to determine insurance finance income and expenses.

204. In addition, if an entity chooses to disaggregate insurance finance income or expenses between profit or loss and OCI, it is permitted to determine the cumulative amount of insurance finance income or expenses recognised in OCI at the transition date:

(a) retrospectively—but only if it has reasonable and supportable information to do so; or

(b) as nil—unless (c) applies; and

(c) for insurance contracts with direct participation features, as an amount equal to the cumulative amount recognised in OCI from the underlying items.

Board's rationale

205. The Board decided to provide a relief to determine the cumulative amount of the insurance finance income or expenses recognised in OCI at transition for groups of contracts. This transition relief is only applicable when an entity chooses to disaggregate the insurance finance income or expenses between profit or loss and OCI.

206. For insurance contracts without direct participation features and for insurance contracts with direct participation features for which an entity does not hold the underlying items, the entity can choose to determine the cumulative amount in OCI applying the retrospective approach or setting it as nil at the transition date. Considering that an entity can only apply the full retrospective approach if it has reasonable and supportable information to do so, the Board decided to provide the possibility to the entity to determine the cumulative amount in OCI as nil if the entity does not have that reasonable and supportable information (for example, when historical data are not available).

Concerns and implementation challenges

207. Some stakeholders are concerned that without a corresponding adjustment to the cumulative amount of income or expenses recognised in OCI for the assets held against the insurance contract liabilities, an accounting mismatch will arise at the transition date, and continue for as long as those assets are held. These stakeholders therefore suggested that the option to determine the amount recognised in OCI at

transition at nil is extended to financial assets that are measured at fair value through OCI.

Staff preliminary thoughts

208. The staff note that the lack of an option for an entity to set OCI to nil at transition for assets classified at fair value through OCI is not a concern arising from IFRS 17 requirements. The staff think that amending IFRS 9 to allow entities issuing insurance contracts to determine the amount recognised in OCI for financial assets that are measured at fair value through OCI as nil at transition would result in a significant loss of useful information for users of financial statements because it would:

   (a) enable entities to 'cherry pick' favourable outcomes by electing to use such option; and

   (b) impair comparability with other entities applying IFRS 9.