AASB Meeting 172
17 September 2019

Australian Government
Australian Accounting Standards Board

10.1_Summary of submission to IASB *ED 2019/4 Amendments to IFRS 17 Insurance Contracts*

Prepared with the support of the Insurance TRG and Actuarial Institute Task Force

Reasons for issuing ED 2019/4

- IFRS 17 Insurance contracts issued in May 2017
- IASB established TRG to discuss implementation questions and met with stakeholders affected by the changes introduced in IFRS 17
- IASB October 2018 Board Agenda Paper – concerns and implementation challenges discussed
- November 2018 AASB TRG submitted response to 25 topics – in 4 areas not in consensus with IASB suggestion:
  - Use of locked in rates to adjust the contractual service margin – persisting issue, similar response suggested in the current draft submission
  - Premium allocation approach
  - Business combinations contracts acquired during the settlement period – persisting issue, similar response suggested in the current draft submission
  - Reinsurance contracts held – persisting issue, similar response suggested in the current draft submission
- IASB proposed targeted amendments to IFRS 17 in June 2019

IASB ED 2019/4 – 12 amendments in 8 areas

Additional scope exclusions

(credit cards, loans)

Allocation of acquisition costs to expected contract renewals

Attribution of profit to service relating to investment activities

Reduced accounting mismatches for reinsurance

Simplified balance sheet presentation

Extension of risk mitigation option

Deferral of effective date by one year

IFRS 17

IFRS 9

Additional transition reliefs

Business combinations

Risk mitigation from the transition date

Risk mitigation and fair value approach

AASB draft submission letter

Staff and AASB Insurance TRG suggest the following:

Areas for which amendments to IFRS 17 were proposed in the ED2019/4	Areas for which no amendments were proposed by IASB in the ED2019/4
Significant change (areas of focus)	
1) Proposed scope of reinsurance recovery recognition	2) Accounting estimates in interim reporting
3) Transition modification and relief	4) Locked in discount rates
Minor change of wording or clarification	
5) Recognition and allocation of acquisition costs	
6) Contractual Service Margin (CSM) attributable to investment service	
7) No change – supporting the standard or the IASB amendment	
Separate presentation of insurance asset and liabilities at portfolio level (though higher entity level would be preferred)	Annual cohorts
Extension of scope of risk mitigation option	
One year extension of the IFRS 9 exemption	
Minor amendments	
Terminology	

Note for the Board – the wording of individual paragraphs of the standard suggested in the submission letter is subject to further review

1) Reinsurance recovery at initial recognition relating to underlying onerous contracts – scope limited to proportionate reinsurance

IASB Question 4

Paragraph 66A proposes that an entity adjust the contractual service margin of a group of reinsurance contracts held that provides proportionate coverage, and as a result recognise income, when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to that group. The amount of the adjustment and resulting income is determined by multiplying:

- *the loss recognised on the group of underlying insurance contracts; and*
- *the fixed percentage of claims on the group of underlying contracts the entity has a right to recover from the group of reinsurance contracts held.*

Do you agree with the proposed amendment? Why or why not?

IASB's reasons for the scope limitation to proportionate reinsurance:

- Inability to identify the amounts that the entity has the right to recover from the reinsurer in respect of the underlying onerous losses recognised ('corresponding reinsurance recoveries'). As per BC 80: "…for reinsurance contracts held that do not provide proportionate coverage, although it is possible to identify the loss as being caused by claims, those claims **do not have a known recovery**…it is not possible to know whether those claims…would result in a recovery, or to what extent…"
- In case of non-proportionate reinsurance an entity would be required to make more arbitrary assumptions to identify the extent to which recoveries relate to a loss recognised on underlying insurance contract

1) Comments on the proposed amendment on reinsurance held (cont)

Agree with amendment to allow the recognition of reinsurance recovery income when the entity recognises losses on onerous underlying contracts.

Do not agree with the scope of the proposed amendment (limitation to "proportionate" coverage) is too narrow, non-proportionate reinsurance should be included.

Results in **accounting that does not represent the economics**:

- Different accounting treatment of reinsurance transactions that have the same economic effect
- Inconsistent treatment across reinsurance contracts of the same nature and substance
- Inconsistent with the subsequent measurement requirement set out in IFRS 17.66(c)(ii)
- Possible inconsistent interpretations as the proposed amendment adds a new distinction ('proportionate' vs 'non-proportionate') that may be difficult to apply

1) Suggested amendment to IFRS 17 on reinsurance

Staff recommend an amendment to the proposals in 66A–66B, B119C–B119F and BC67–BC90 of the ED 2019/4 to allow for application to all reinsurance contracts held for which there is a direct link between the expected recoveries and the loss recognised on underlying onerous contracts.

This is consistent with AASB response to the IASB October 2018 Board Agenda.

Question to the Board:

Does the Board agree the scope of the amendment should be extended to include non-proportionate reinsurance?

1) Practical example of AASB's suggestion

Reinsurance recoveries that relate to an onerous underlying loss recognised can be determined **without making arbitrary assumptions** and by using a simple methodology that can be **applied consistently** by all entities for all types of reinsurance contracts.

Insurance contracts issued	
Premiums	**100**
Claims	**(150)**
Expected loss (recognised immediately)	**(50)**

XOL reinsurance contract which will pay recoveries for all claims above a deductible of CU30 for reinsurance premiums of CU125:

XOL reinsurance contract held	
Reinsurance premiums	**(125)**
Claims recovered from reinsurance	**120**
Net cost	**(5)**
Recovery % = 120/150	**80%**
Recovery that corresponds to the onerous loss = 80% x CU50	**40**

The recovery percentage is the allocation of the insurer's right to recover under the reinsurance contract to each underlying claim (including the claims that make up the underlying loss of CU50).

2) Accounting estimates in interim reporting financial statements

- IFRS 17 B137 : no change to the treatment of accounting estimates made in previous interim financial statements when applying IFRS 17 in subsequent reporting period (exemption to IAS 34.28);
- IASB decided no change to IFRS 17 B137 required;
- AASB TRG suggesting a change to IFRS 17 to permit but not require the exemption as mandating the exemption can cause additional compliance costs.

Question to the Board:

Does the Board agree to ask IASB to change IFRS 17 B137 to be an option?

3) Transition modifications and reliefs

IASB Question 8

Paragraph C9A proposes an additional modification in the modified retrospective approach. The modification would require an entity, to the extent permitted by paragraph C8, to classify as a liability for incurred claims a liability for settlement of claims incurred before an insurance contract was acquired.

Paragraph C22A proposes that an entity applying the fair value approach could choose to classify such a liability as a liability for incurred claims.

Do you agree with the proposed amendments? Why or why not?

- The AASB TRG agree with the proposed amendment above relating to the transition period but suggest to extend it to post transition periods (on an ongoing basis)
- Indication of the amendment – all contracts acquired in their claims settlement period after transition should be treated as liability for remaining coverage (in accordance with IFRS17 B5 "*Some insurance contracts cover events that have already occurred but the financial effect of which is still uncertain. Example is an insurance contract that provides insurance coverage against an adverse development of an event that has already occurred. In such contacts, the insured event is the determination of the ultimate cost of those claims*").

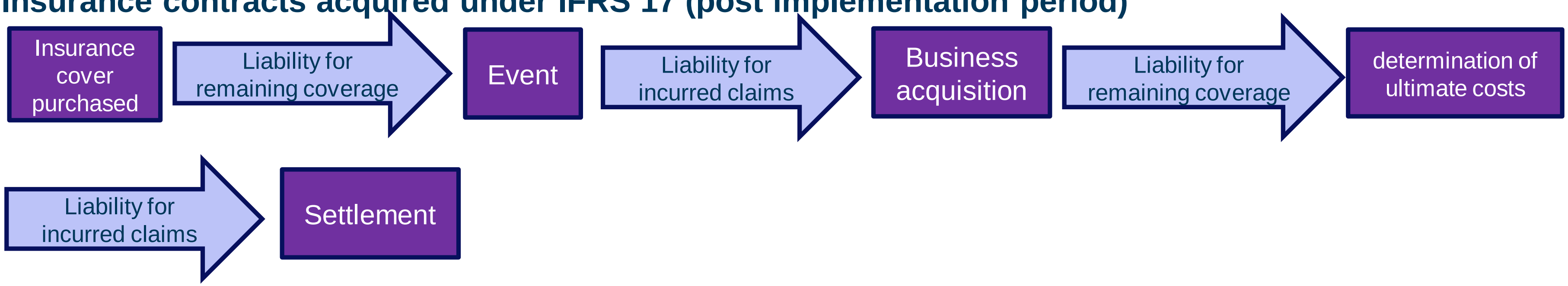
3) Liability calculation post business acquisition (cont)

IFRS17 B5 "*Some insurance contracts cover events that have already occurred but the financial effect of which is still uncertain. Example is an insurance contract that provides insurance coverage against an adverse development of an event that has already occurred. In such contacts, the insured event is the determination of the ultimate cost of those claims*"

Insurance contracts against an adverse development

Usual insurance contracts

Insurance contracts acquired under IFRS 17 (post implementation period)



3) Transition modifications and reliefs (cont)

The impact of the accounting treatment of acquired insurance contracts in their settlement period per AASB TRG:

- Significant operational complexity and costs
- Change of classification of the insurance contract (e.g. general model might be required instead of premium allocation approach, financial instrument accounting instead of insurance accounting) and inconsistency with accounting for similar contracts by the entity, which may be misleading for the users of financial statements

AASB TRG suggests that in case of financial instruments, IFRS 3 introduces requirements for remeasurement but doesn’t change the classification of financial instrument.

Accordingly, same logic should be applied in IFRS 17 and classification of insurance contracts should not change.

Question to the Board:

Does the Board want to suggest to IASB that the transitional relief should be extended to future acquisitions?
Are the implications stated on the previous slide significant enough to warrant a different treatment for insurance sector when applying IFRS 3?

4) Locked-in discount rates

- IASB does not propose any change to this area
- IFRS 17 requires use of the inception date interest rate to accrete Contractual Service Margin (CSM)
- Inconsistent with current value nature of other elements of IFRS 17
- Creates accounting mismatch
- Suggested solution by AASB TRG: Current discount rates should apply to all aspects of the insurance standard including CSM. This is consistent with AASB response to the IASB October 2018 Board Agenda and previous discussions with the IASB. As a minimum allow relief for reinsurance held with long contract boundary.

Question to the Board:

Does the Board agree that use of locked-in rates is causing an accounting mismatch?

5) Recognition and allocation of acquisition costs

IASB Question 2

Paragraphs 28A-28D and B35A-B35C propose that an entity:

a) allocate, on a systematic and rational basis, insurance acquisition cash flows that are directly attributable to a group of insurance contracts to that group and to any groups that include contracts that are expected to arise from renewals of the contracts in that group;

b) recognise as an asset insurance acquisition cash flows paid before the group of insurance contracts to which they are allocated is recognised; and

c) assess the recoverability of an asset for insurance acquisition cash flows if facts and circumstances indicate the asset may be impaired.

Paragraphs 105A–105C propose disclosures about such assets.

Do you agree with the proposed amendments? Why or why not?

Staff agree with the proposed amendment, however, three areas may require further consideration:

1) B35A indicates all directly attributable insurance acquisition costs are incorporated, irrespective of whether recovered through future renewals - potential process redesign and disrupt to implementation projects.
   AASB TRG suggested solution: Change of the wording required.

5) Recognition and allocation of acquisition costs (cont)

2) Determination of asset (acquisition costs attributable to future insurance contracts) upon transition to IFRS 17 requires historical information relating to the insurance contracts – i.e. significant cost and complexity.
AASB TRG suggested solution: Include explicit allowance for the recognition of the asset proposed in paragraph 28B(b) as part of the modified retrospective and fair value transition approaches

3) 28B(b) indicates a different asset should be recognised for each group instead of a single asset for all groups.
AASB TRG suggested solution: Change of the wording required.

Question to the Board:

Does the Board agree that a clarification of the areas discussed above is required?

6) Contractual service margin (CSM) attributable to investment service

TRG agree with the proposed amendment to include investment-return services in the scope of the CSM, however, the proposed wording needs to be clarified:

Definition of an investment-return service that requires a ‘*positive investment return*’ is raising the following issues:

- Not clear what ‘positive investment return’ is.
- Is it possible to have an investment component that doesn’t provide an investment return service (because no ‘positive investment return’)?
- Implies retrospective calculation of investment component value – yet a typical surrender value is calculated prospectively – what is the inclusion then?
- Not clear whether costs related to tax payments attributable to the policyholder are included in fulfilment cash flows

In addition a further clarification required that costs related to tax payments attributable to the policyholder are included in fulfilment cash flows along the lines of that included by the IASB to deal with investment management services provided for and on behalf of the policyholder

Question to the Board:

Does the Board agree that a clarification of an investment-return service is required?

7) Other areas

AASB TRG is supportive of remaining IASB amendments:

- Separate presentation of insurance asset and liabilities at portfolio level (though higher entity level would be preferred)
- Extension of scope of risk mitigation option
- One year deferral of effective date
- One year extension of the IFRS 9 exemption
- Minor amendments
- Terminology

AASB TRG support other areas the IASB considered but did not propose amendments to IFRS 17 as listed in the submission letter page 26

- Premium Allocation Approach premium received
- Level of aggregation (annual cohorts)
- Discount rates and risk adjustment
- OCI option for insurance finance income or expense
- Insurance contracts with direct participation features