IFRS Transition Resource Group for IFRS 17 *Insurance Contracts* (TRG)

Subsequent treatment of contracts acquired in their settlement period (S04 in Agenda paper 7 of the February TRG meeting)

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Introduction

At its first meeting in February 2018, the Transition Resource Group (TRG) for IFRS 17 *Insurance Contracts* raised concerns over implementation challenges identified by insurers in practically applying the requirements of IFRS 17. The IASB staff followed up with specific questions to TRG members designed to understand the issues in more detail. These questions are included in this document.

Topic 3

Subsequent treatment of contracts acquired in their settlement period (S04 in Agenda paper 7 of the February TRG meeting).

Issue

Paragraph B5 of IFRS 17 states that for contracts that cover events that have already occurred but the financial effect of which is still uncertain, the insured event is the determination of the ultimate cost of the claim. Acquiring contracts in their settlement period, either through a business combination or a portfolio loss transfer in which contracts are novated to the acquiring party, is therefore treated as being equivalent to issuing a contract that provides coverage for the adverse development of claims. Consequently, the coverage duration would be the expected claims settlement period. A liability for remaining coverage (LfRC) (including CSM for any gain) will need to be recognised on acquisition/transfer and will be allocated to the P&L over the expected claims settlement period based on coverage units. Revenue in each period will reflect the reduction in the LfRC for settled claims, measured at the amount of expected claims settlement, as reassessed at each reporting date. The insurance service expense will reflect the actual claims settlement amounts in the reporting period.

This is a significant change from current accounting requirements whereby the acquired contracts are measured on the basis of the loss event for which the insurance contracts were originally written and therefore no revenue is recognised from the transaction unless there is an “unearned premium” component in the acquisition or loss portfolio transfer.

The requirements in IFRS 17 will result in a significant grossing up of revenue across the insurance industry because revenue would be recognised twice (albeit not as identical amounts) for the same group of contracts – first by the insurer who issued the contracts and subsequently, by the acquirer of the group of contracts as the claims are settled.

This approach also poses some significant operational challenges for contracts acquired in their settlement periods as set out below.

Q1. Please describe any specific implementation challenges that you have identified as a result of applying the requirements in IFRS 17 for contracts acquired in their settlement periods

Acquired liabilities for incurred claims are expected to have claims settlement periods which are longer than a year in many, if not most, cases even though the original underlying contracts may have been annual contracts. For a general insurer, where a high percentage of business is annual contracts and the PAA is applied, there will be significant operational issues associated with on-boarding acquisitions and portfolios transfers as follows:

a) Different accounting approaches

Paragraph B93 of IFRS 17 states that an acquirer will need to identify groups of contracts as if the contracts had been entered into at the date of acquisition. Where acquired contracts in their claims settlement periods are grouped with insurance contracts issued, this may **preclude the application of the simplified approach for the group of contracts** even though the other insurance contracts in the group have short (one year) coverage periods. Accounting and reporting of businesses will be more complex for both preparers and users of the financial statements in situations where existing portfolios are accounted for as PAA but on-boarded business (which is otherwise identical in nature) is required to apply the general approach (due to the longer coverage period based on claims settlement).

b) Additional data required to apply the general model

If required to apply the general model to measure acquired claims liabilities, a CSM will need to be established for any gain on initial recognition. Applying the general model (both in relation to acquired claims liabilities and more generally to insurance contracts issued) is more operationally challenging than applying the simplified approach, but the challenge is expected to be greater for acquired claims liabilities with long settlement periods due to the requirement to track and store data over a longer period. The requirements set out below are expected to require additional data and processes to be implemented:

- identify “groups” of acquired claims liabilities on acquisition date;
- store and track acquisition date discount rates for the accretion of interest on the CSM;
- determine and reassess coverage units for the allocation of CSM to the P&L in each period of coverage to the final settlement of the claims; and,
- identify changes to fulfilment cash flows that could unlock the CSM in each period of coverage to the final settlement of the claims .

b) Challenges for transitional application

Historical acquisitions of claims liabilities with unsettled claims as at the transition date will need to be measured as if IFRS 17 had always applied from the date of acquisition. We note the availability of transitional reliefs (application of the modified retrospective or fair value approach) where it is impracticable to apply the full retrospective approach. However, where it is not determined to be impracticable, a significant amount of effort will be required to obtain and validate the data required to apply the IFRS 17 measurement requirements for claims acquired in their settlement period as the data may be available but is unlikely to be readily available at the required level of granularity or accuracy. The data requirements that are expected to be most challenging to apply are:

- the determination of facts and circumstances that existed at acquisition date for measurement of the acquisition date CSM and level of aggregation.
- identification of assumptions about expected cash inflows/outflows relating to future services for each period between the acquisition date and transition date to derive the transitional CSM balance.

Q2. Do your observations apply equally for life and non-life contracts acquired?

The requirements are expected to be more challenging for non-life insurers as the majority of the contracts issued have short coverage periods and would therefore, be expected to qualify for the simplified approach.

The implementation challenges to apply the requirements on transition and the implications of the grossing up of revenue are expected to apply equally to life and non-life contracts and we see this as a broad industry issue and would urge the IASB to consider the significant overall gross up of revenue for the industry as a whole and what implications this has for the industry and users of financial statements as well as preparers as we do not believe the full implications of this change have been well understood..

Q3. Please specify whether your comments relate to measuring such contracts or determining the amount of insurance revenue and insurance service costs related to such contracts or both

These challenges presented in this paper would apply to both the measurement of acquired contracts and the determination of insurance revenue related to those contracts.

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