Australian Government
Australian Accounting Standards Board

AASB 17 *Insurance Contracts* Transition Resource Group update

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AASB 17 TRG Chair

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Objective of this Board Paper

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- This objective of this Board Paper is to update the Board on the local and international implementation status of IFRS 17 *Insurance Contracts*.
- This paper does not contain any questions for the Board, but is for discussion and noting only. AASB 17 TRG Chair Anne Driver will present on this topic at this meeting and this paper will be used as a reference point for the presentation.
- Appendix A provides the Board with a refresher of the accounting models in AASB 17.
- Attached also for Board noting only is:
  - **Agenda Paper 7.2:** letter dated 3 September 2018 from EFRAG to IASB Re: IFRS 17 Insurance Contracts: Issues raised by constituents
  - **Agenda Paper 7.3**: letter dated 18 October 2018 to EFRAG Re: the European endorsement process of IFRS 17 *Insurance Contracts*

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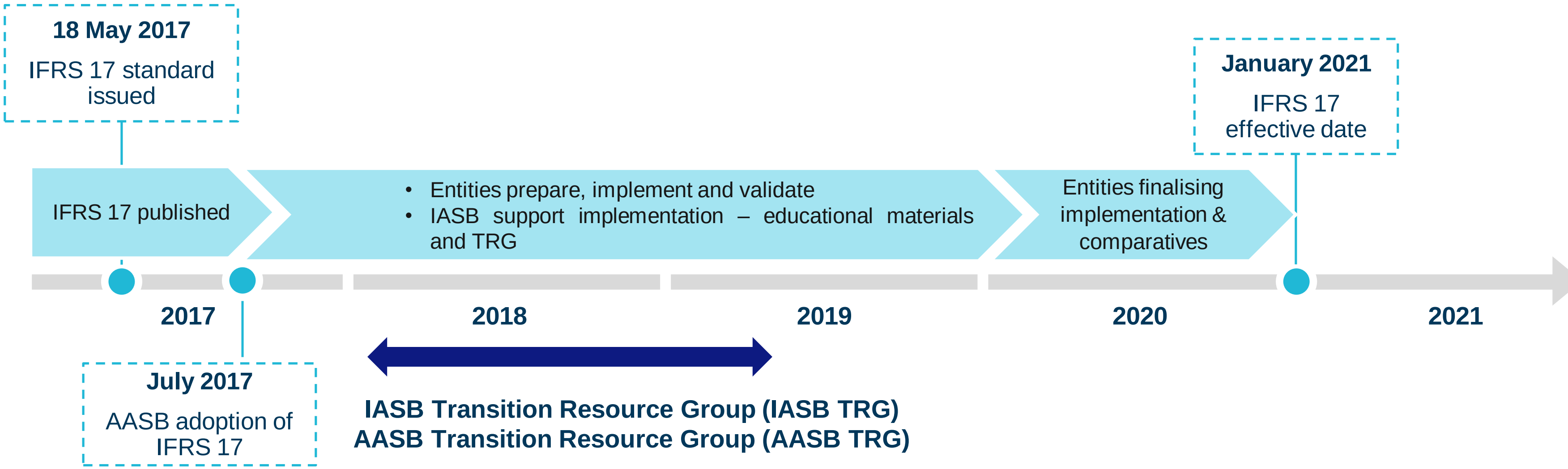
Introduction



Calls for delay in the effective date of IFRS 17:

- Ten insurance industry organisations from Europe, Canada (x2), Korea, New Zealand, Australia (ICA), and South Africa have written a joint letter to the IASB asking for a two-year delay in the effective date of the Standard – October 2018
- No formal delay requests made to the AASB Staff or discussed by the AASB TRG. ICA support for the letter referred to above is first Australian request seen by the AASB Staff.
- Potential delays to EU endorsement process signalled
- In AP2D of the IASB October Board papers, IASB staff acknowledge stakeholder requests for a delay but also noted that other stakeholders have expressed concerns that a deferral could lead to increased costs

IASB Transition Resource Group (TRG)

The IASB TRG provides implementation support for IFRS 17. The TRG cannot make changes to the standard. The TRG informs the IASB who have the option to (1) provide more education support (2) refer matters to IFRIC and (3) change IFRS 17.

Topics discussed in previous IASB TRG meetings (Feb, May and Sep 2018)

- ★ Contract boundary
- Premium experience adjustments related to current or past service
- Separation and combination of insurance contracts (and application to group policies)
- ★ Coverage units
- ★ Separate presentation of assets and liabilities on the balance sheet
- ★ ‘Premiums received’ in PAA
- ★ Treatment of claims acquired in their settlement period
- Insurance risk consequent to an incurred claim
- Determining discount rates using a top-down approach
- Commissions and reinstatement premiums in reinsurance contracts issued
- ★ Risk adjustment
- Premium waivers
- Insurance acquisition cash flows
- Industry pools managed by an association
- Annual cohorts for contracts that share in the return of a specified pool of underlying items

The next IASB TRG meeting will take place on 4th December 2018 but this may be rescheduled to early 2019 to accommodate a longer period for submissions.

★ Identified by AASB TRG as key Australian industry issues

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AASB Transition Resource Group (TRG)

- **Established by the AASB to provide a transparent forum to support the Australian insurance industry through transition**
- **Two areas of focus:**
  1. **Review papers issued by the IASB TRG**
     - Allows increase in local understanding of the issues
     - Allows a broader view to be presented to the IASB TRG by Australian member
  2. **Review local Australian issues arising from AASB 17 implementation / interpretation**

Received positive feedback from global preparers and seen as an example for other local TRGs

Key areas of active AASB TRG participation in global interpretation

Use of 'premiums received' when applying PAA

- Endorsed a submission from the ICA to the IASB TRG in January 2018 (S23 of AP7 IASB Feb 2018 TRG).
- Issue addressed through paper AP06 IASB May 2018 TRG and is included for discussion at the IASB October Board meeting on 24 October 2018.

Coverage units

- Provided feedback on the paper submitted to the IASB as part of the IASB outreach on coverage units.
- Content included in AP05 IASB May 2018 TRG which clarified that factors other than maximum contractual cover can be considered to determine coverage units.

Contract boundary

- Endorsed a submission to the IASB TRG in March 2018. This paper has been referenced in AP03 of the IASB May 2018 TRG papers.

Risk adjustment

- Endorsed a submission to the IASB TRG in July 2018 (S81 of AP11 IASB September 2018 TRG).
- This issue has also been included for discussion at the IASB October Board meeting on 24 October 2018.

Reinsurance held

- The AASB raised and discussed this issue with the IASB and national Standard Setters globally.
- Discussions have highlighted to the IASB that this is a global issue (not limited to Europe).
- This issue has been included for discussion at the IASB October Board meeting on 24-25 October 2018.

Other global market activity

Europe

European Financial Reporting Advisory Group (EFRAG) case study

In May 2018, EFRAG invited preparers to provide their views on the impact of IFRS 17 as a key input into its endorsement advice to the European Commission. This included an extensive case study (11 participants) and a simplified case study (49 participants).

EFRAG letter to the IASB (attached for Board noting as Agenda Paper 7.2 for Board noting)

Based on the findings from the case study, EFRAG has written to the IASB to highlight certain aspects of IFRS 17 that merit further consideration:

- Acquisition costs incurred in expectation of renewals
- Amortisation of the Contractual Service Margin (CSM) (including investment services)
- Reinsurance (onerous underlying contracts that are profitable after reinsurance, contract boundary where underlying contracts are not yet issued)
- Transition – modified retrospective and fair value approaches
- Annual cohorts
- Balance sheet presentation (separate disclosure of ‘groups’ of insurance contracts in an asset position and ‘groups’ of insurance contracts in a liability position)

European regulators letter to EFRAG (attached as Agenda Paper 7.3 for Board noting)

A group of European regulators have written a joint letter to EFRAG, encouraging the group to continue to progress and finalise its endorsement process for IFRS 17 Insurance Contracts, in time for IFRS 17’s effective date of 1 January 2021

IASB October Board meeting

IASB discussed IFRS 17 issues in its October 2018 meeting:

- AP2C discussed criteria that the Board should consider in evaluating possible amendments to IFRS 17.
- AP2D discussed concerns raised by stakeholders (including those raised in the EFRAG letter to the IASB) and the staff consideration of whether these meet the criteria described in AP2C.
- Concerns discussed include those identified as the top Australian industry issues (see next slide) as well as requests for a delay in the effective date of IFRS 17.
- No decisions were made at this meeting. IASB staff will bring back the issues to future IASB meetings.
- The IASB Board agreed with the proposed criteria for evaluating whether changes should be made but emphasised that even if the criteria were met, they would still consider whether changes were justified.

Top Australian industry issues

Top Australian industry issues

1. **Balance sheet presentation of groups of assets and liabilities | Premiums received when applying the simplified approach (i.e. the premium allocation approach (PAA))**

2. **Treatment of reinsurance held on initial recognition where they cover onerous underlying contracts issued**

3. **Measurement of risk adjustment at the level of a consolidated Group**

Issue 1: Balance sheet presentation of groups of assets and liabilities | Premiums received in PAA

Balance sheet presentation of groups of assets and liabilities

In applying the measurement requirements of AASB 17, an entity must aggregate insurance contracts into ‘groups of contracts’.

The carrying amount of ‘groups of contracts’ in an asset position are presented separately on the Balance Sheet from those in a liability position within Insurance assets or Insurance liabilities respectively.

Premiums received when applying the PAA

- Under the Premium Allocation Approach (PAA), the liability for remaining coverage (LfRC) is measured on the basis of ‘premiums received’.
- Whether a ‘group of contracts’ is in an asset or liability position is largely driven by the timing of premium receipts.
- The requirement to identify **premiums received** by **group of contracts** for balance sheet aggregation (see above) presents **significant implementation challenges** for general insurers. Cash receipts are not used as the basis of any current financial accounting, regulatory or tax reporting and therefore, underwriting and reporting systems are not designed to identify and extract cash receipt balances at the required level of granularity (i.e. ‘groups of contracts’).

AASB TRG members considered that the **presentation of groups of assets and liabilities** does not provide information that is meaningful, both internally for management purposes and to users of financial statements.

The AASB endorsed a submission from the ICA to the IASB TRG in January 2018 on the use of the term ‘premiums received’ when applying the PAA (S23 of AP7 IASB Feb 2018 TRG). This is addressed through paper AP06 IASB TRG May 2018 and is included for discussion at the IASB October 2018 Board meeting on 24 October 2018. The IASB staff consider that it <u>may be possible to amend IFRS 17</u> to allow aggregation at ‘portfolio’ level instead of ‘group’ level for balance sheet presentation (AP2D IASB October Board papers). This would significantly benefit implementation.

Issue 2: Treatment of reinsurance held on initial recognition

Issue: Accounting mismatch on initial recognition

A loss on onerous insurance contracts issued is recognised **immediately in the P&L.**

Underlying insurance contracts issued

Dr	**Cr**
Loss recognised immediately in P&L	**Risk adjustment**
Expected cash inflow from policyholders (premiums)	**Expected cash outflows (claims and expenses)**

Insurance contract liability (Balance sheet)

Reinsurance contracts held

Dr	**Cr**
CSM – net gain	**Risk adjustment**
Expected cash outflow to reinsurer (premiums)	**Expected cash inflows (recoveries and commissions)**

Reinsurance contract asset (Balance sheet)

A corresponding gain on the related outwards reinsurance must be recognised as unearned profit (CSM) on the balance sheet and **recognised in the P&L over the coverage period** of the reinsurance contract.

- Does not reflect the economics of the reinsurance arrangement as a risk mitigant
- Inconsistent with the subsequent measurement requirement in AASB 17.66(c)(ii) which allows a subsequent gain on reinsurance held to be recognised in the P&L where they result from changes in the underlying contracts subsequent to initial recognition (e.g. underlying contracts become more or less onerous)
- Inconsistent with similar principles in other accounting standards – e.g. hedging in IFRS 9, measurement of expected credit losses in IFRS 9, recognition of a reimbursement right in IAS 37

This issue has been discussed at the AASB TRG and subsequently raised and discussed with the IASB and national Standard Setters globally. This issue has also been included for discussion at the IASB October Board meeting on 24 October 2018. The IASB staff consider that it <u>may be possible to amend IFRS 17</u> to extend to initial recognition a modification for onerous underlying groups of contracts (AP2D IASB October Board papers).

Issue 3: Measurement of risk adjustment at the level of a consolidated Group

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".

The risk adjustment should reflect the degree of diversification benefit the entity includes when determining the compensation it requires for bearing that risk [IFRS 17.B88].

Discussions at TRG confirmed diversification benefit is reflected in the **individual entity risk adjustment** to the extent it is considered by the entity

Two views expressed by TRG members on the **consolidated risk adjustment**:

1) Consolidated risk adjustment is the aggregate of subsidiary risk adjustments (IASB staff view)
2) Consolidated risk adjustment need not be the aggregate of subsidiary risk adjustments but would reflect the Group's view of the risk adjustment, which may be different from the aggregate of subsidiary risk adjustments

- IASB Staff view on diversification benefit confirmed that consolidated Groups can push down diversification benefit to subsidiaries – helpful for implementation
- Re consolidated risk adjustment - View 1 may result in a lack of ability to compare Groups of companies

A paper was submitted through the AASB TRG to the IASB TRG for discussion in September (S81 of AP11 IASB September 2018 TRG). This issue has also been included for discussion at the IASB October Board meeting on 24 October 2018. IASB staff consider that amending IFRS 17 to allow for different measurement of risk adjustment at the different reporting levels would add complexity for entities within a Group, but have not proposed to amend IFRS 17 to lock down a specific view.

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What's next?

The IASB October Board paper 2D included 25 areas of stakeholder concerns and considered whether these potential changes met the suggested criteria for potential changes. In 7 of the 25 areas, the IASB staff appears to see potential for considering changes to the Standard.

OUTCOMES OF IASB OCTOBER 2018 BOARD MEETING

- The IASB Board agreed with the staff's suggested criteria for assessing whether individual concerns of stakeholders, including the effective date, warranted further investigation for potential changes.
- No decisions were made on whether changes should be made and **IASB staff will bring back the issues to future meetings of the IASB.**
- The IASB Board emphasised that they would not want to make any changes that violated the principles or decisions made in developing the Standard. Changes should only be considered when new information had come to the attention of the Board or staff. They agreed that changes should be **limited to changes that could be made quickly without imposing significant disruption to implementation.**

IASB staff suggested criteria for assessing whether to amend the standard (AP2C)

The IASB staff recommend that the IASB's assessment of whether changes should be made be based on the following criteria:

a) the amendments would not result in significant loss of useful information for users of financial statements

b) the amendments would not unduly disrupt implementation processes that are already under way or risk undue delays in the effective date of the Standard

AABS TRG members are drafting an Australian response to the IASB October Board paper on the issues raised in AP2D to assist the IASB in their forthcoming assessments, including proposed simple solutions where appropriate.

Appendix: AASB 17 refresher

Appendix: Overview of measurement models

IASB aims for IFRS 17 to bring:

- **Consistent accounting**
- **Comparability**
- **Up to date information**
- **Increased transparency**

Measurement Models

General model (GM) aka Building Block Approach (BBA)	Default model for all insurance contracts	Should be applied to all insurance contracts, unless they have direct participation features or the contract is eligible for, and the entity elects to apply, the PAA
Variable fee approach (VFA)	Model for direct participating business	Should be applied to insurance contracts with direct participation features, i.e. where payments to policyholders are contractually linked and substantially vary with the underlying items. Cannot be used for reinsurance held
Premium allocation approach (PAA)	Optional simplified measurement for short term contracts	Optional simplification for measurement of unexpired coverage for insurance contracts with short term coverage

Appendix: Key measurement models used in Australia

What IFRS 17 requires:

- Measurement model for insurance contracts based on:
  - expected future cash flows;
  - discounted to reflect time value of money; and
  - a risk adjustment to reflect the compensation the insurer requires to bear risk
- The expected profit in a contract is measured on day one (CSM) and released over the coverage period
- Early recognition of potential loss making contracts