IFRS 17 Accounting Issues

ASSET FOR INSURANCE ACQUISITION CASH FLOWS – TRANSITION IMPLICATIONS

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Asset for Insurance Acquisition Cash Flows

Contents

1 Purpose of the Paper

This paper discusses interpretations around the requirement for entities to recognise an asset for insurance acquisition cash flows on transition.

The paper discusses:

(a) Whether an entity applying the premium allocation approach at transition may recognise **all** insurance acquisition cash flows as expenses, prior to allocating insurance acquisition cash flows to the expected future renewal groups of insurance contracts on a systematic and rational basis; and
(b) Whether an entity applying the general measurement model at transition may choose to apply one transition relief for the group that is recognised at the transition date, but choose a different transition relief for the expected future renewal groups of insurance contracts recognised after the transition date.

2 Premium Allocation Approach (PAA) at Transition

2.1 Proposals in the Exposure Draft

The Exposure Draft:

(a) Proposed in paragraph 28A that an entity applying the premium allocation approach may recognise insurance acquisition cash flows as expenses applying paragraph 59(a)[1]. Otherwise, the entity shall allocate insurance acquisition cash flows to a group of insurance contracts on a systematic and rational basis applying paragraph B35A[2].
(b) Proposed in paragraph 28B(b) that insurance acquisition cash flows paid before the related group of insurance contracts is recognised as an asset. An entity shall recognise such an asset for each existing or future group of insurance contracts to which insurance acquisition cash flows are allocated.
(c) Proposed in paragraph 28C that an entity shall derecognise an asset recognised applying paragraph 28B(b) when the insurance acquisition cash flows allocated to the group of insurance contracts are included in the measurement of the group applying paragraph 38(b).
(d) Proposed in paragraph 28D that at the end of each reporting period, an entity shall assess the recoverability of an asset recognised applying paragraph 28B(b) if facts and circumstances indicate the asset may be impaired.

2.2 Interpretations of these Proposals

There is consensus that:

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[1] Paragraph 59(a) allows this only for groups of insurance contracts applying the premium allocation approach where each contract in the group has a coverage period at initial recognition of one year or less.

[2] Paragraph B35A outlines the requirements to apply paragraph 28A. It specifies that the entity allocates insurance acquisition cash flows that are directly attributable to a group of insurance contracts to **that** group and also to groups that include insurance contracts that are expected to arise from renewal of the insurance contracts in **that** group.

(a) Once insurance acquisition cash flows are allocated to future expected renewal groups of insurance contracts, then an asset is held for the amount of insurance acquisition cash flows that relate to each future expected renewal group of insurance contracts; and
(b) If (a) is met, then the entity shall assess the recoverability of the asset. This is likely to create significant strain on business processes.

There are different interpretations of the application of paragraph 28A on transition. Consider a group of insurance contracts that are measured under the premium allocation approach and this group is already being recognised at the transition date.

Suppose this is a group of yearly renewable term life insurance contracts, where each contract has a contract boundary of one year and is likely to renew in the future.

Suppose that the entity paid CU10,000 of insurance acquisition cash flows in the past to acquire the group of insurance contracts, and that these costs do not have to be paid again for future renewals of those contracts.

Suppose that the entity expects all insurance contracts within this group to renewal exactly 3 more times in the future, with no subsequent renewals thereafter.

2.2.1 View A – Allocate Insurance Acquisition Cash Flows to Future Renewal Groups

The entity identifies that CU10,000 are insurance acquisition cash flows paid to acquire the group of insurance contracts currently recognised at the transition date, but also for the rights to the 3 expected renewal groups in the future.

The entity allocates CU2,500[3] to the current group, and CU2,500 to each future renewal group of insurance contracts.

Applying paragraph 28A, the entity recognises CU2,500 of insurance acquisition cash flows as expenses for the PAA group that goes through the transition date.

Applying paragraph 28B(b), the entity recognises at the transition date an asset of CU2,500 for insurance acquisition cash flows relating to each future renewal group, and this amounts to CU7,500.

Applying paragraph 28C, the entity will derecognise CU2,500 of the asset on recognition of each renewal group of insurance contracts.

Applying paragraph 28D, the entity will assess the recoverability of each CU2,500 of insurance acquisition cash flow asset at the end of each reporting period.

2.2.2 View B – Recognise All Insurance Acquisition Cash Flows as Expenses

The entity identifies that CU10,000 are insurance acquisition cash flows paid to acquire the group of insurance contracts currently recognised at the transition date, but also for the rights to the 3 expected renewal groups in the future.

The entity applies paragraph 28A to recognise all insurance acquisition cash flows as expenses at the transition date. This is the entire CU10,000. The entity recognises the entire CU10,000 because all insurance contracts within the group have a contract boundary of one year, and the group is measured under the PAA.

[3] There are four groups in total, so dividing CU10,000 by 4 yields CU2,500.

Applying paragraph 28B(b), the entity recognises at the transition date no asset for insurance acquisition cash flows relating to future renewal groups. This is because all insurance acquisition cash flows have been recognised as expenses at the transition date.

Questions 1 and 2 for Discussion
1. Do you agree with View A or View B? 2. The transition requirements were brought in specifically to target insurance acquisition cash flows that were recoverable over multiply renewal groups of insurance contracts. Usually insurance contracts of a one year term are the ones which are most likely to renewal (e.g. yearly renewable term policies or compulsory third party). If you agree with View B, then under what practical circumstances would the transition requirements related to assets for insurance acquisition cash flows apply?

3 Consistency Between Transition Reliefs for Renewal Groups of Insurance Contracts

3.1 Proposals in Agenda Paper 2E of January 2020 IASB Board Meeting

The agenda paper:

(a) Proposed to require an entity to identify, recognise and measure an asset for insurance acquisition cash flows at the transition date; and
(b) Proposed that if, and only if, it is impracticable for the entity to apply IFRS 17 retrospectively to measure an asset for insurance acquisition cash flows at the transition date to apply either:
  i. the modified retrospective approach; or
  ii. the fair value approach

3.2 Interpretations of these Proposals

There is consensus that:

(a) Application of the modified retrospective approach could lead to no asset for insurance acquisition cash flows and no adjustment to the contractual service margin of the groups of insurance contracts at the transition date. If this is the case, then is likely to lower the administrative burden on the entity.
(b) The fair value approach is supposed to be a purely *forward-looking* method to determining the asset for insurance acquisition cash flows. However there does not appear to be the same explicit relief as the modified retrospective approach, where in the absence of reasonable and supportable information, the entity is permitted to have no asset for insurance acquisition cash flows and no adjustment to the contractual service margin of the groups of insurance contracts at the transition date. This is likely to increase the administrative burden on the entity.
(c) There must be consistency in the use of the transition reliefs i.e. the same transition approach must be used to determine the opening balance of the CSM at the transition date, as well as the asset for insurance acquisition cash flows

There appears to be differences in views of how the transition reliefs are applied to future renewal groups of insurance contracts.

Consider a group of insurance contracts measured under the general measurement model.

Suppose this is a group of insurance policies, each with a 2 year contract boundary and are expected to renew 3 times in the future.

The entity chooses to apply the fair value approach to determining the opening contractual service margin of the group at the transition date.

3.2.1 View A – Transition Approach is Consistent for All Renewal Groups

In this view, the entity applies the fair value approach to determine:

- the opening contractual service margin for the group of insurance contracts that is recognised at the transition date; and
- the adjustment to the opening contractual service margin due to insurance acquisition cash flows
- the asset for insurance acquisition cash flows related to each of the 3 future renewal groups

The entity determines that there is a non-zero asset for insurance acquisition cash flows related to each of the 3 future renewal groups and is expected to assess the recoverability of these assets if facts and circumstances indicate the asset may be impaired.

The entity acknowledges that this may be administratively burdensome, due to the need to track the assets for insurance acquisition cash flows over time, as well as the assessment of their recoverability.

3.2.2 View B – Transition Approach is Not Consistent for All Renewal Groups

In this view, the entity applies the fair value approach to determine:

- the opening contractual service margin for the group of insurance contracts that is recognised at the transition date; and
- the adjustment to the opening contractual service margin due to insurance acquisition cash flows

However, the entity believes that the transition approach for each renewal group should be assessed independently and chooses to apply the modified retrospective approach for each of the 3 renewal groups to determine the asset for insurance acquisition cash flows.

The entity then determines that there is no reasonable and supportable information necessary to quantify the asset for insurance acquisition cash flows and, applying paragraph 25(b) of Agenda Paper 2E, does not recognise any asset for insurance acquisition cash flows.

Therefore under this view, the entity has consistently used the fair value approach to determining the contractual service margin and the adjustment to the contractual service margin due to insurance acquisition cash flows for the transition group of insurance contracts. The entity then applied a separate transition approach to determining the asset for insurance acquisition cash flows for each of the renewal groups of insurance contracts.

Question 3 for Discussion
3. Do you agree with View A or View B?