EY
Building a better working world

May 2020

Insurance Accounting Alert

IASB agrees amendments to IFRS 17 for seven sweep issues

What you need to know

At its meeting on 20 May 2020, the IASB discussed seven "sweep issues" identified during the balloting process for finalising the amendments to IFRS 17. The IASB agreed to amend IFRS 17, as follows:

- An entity is to include in the initial measurement of the contractual service margin (CSM), the effect of the derecognition of any asset or liability previously recognised for cash flows paid or received before the related group was recognised, not limiting this to insurance acquisition cash flows only.
- The asset for insurance acquisition cash flows that is recognised before a group of insurance contracts has been recognised should include future cash flows for which a liability has been recognised applying another IFRS standard.
- When an entity has a group of onerous underlying insurance contracts, some of which are covered by reinsurance and some not, the entity has to determine how to calculate a loss recovery component to be included as part of its reinsurance held asset. The IASB agreed to require an entity to use a systematic and rational method of allocation to do this.
- When an entity recognises in profit or loss, amounts related to income tax that are specifically chargeable to the policyholder under an insurance contract, it should recognise insurance revenue for the relevant part of the amount chargeable.
- The definitions of the liability for remaining coverage and the liability for incurred claims have been amended to clarify that they include all obligations arising from insurance contracts issued.
- The IASB agreed to amend the requirements for the risk mitigation option in the variable fee approach (VFA) to:
  - Specify that the accounting policy choice (in paragraphs 88-89 of IFRS 17) to present parts of insurance finance income or expenses (IFIE) in other comprehensive income (OCI) and parts in profit or loss does not apply to IFIE arising from the application of the risk mitigation option.
  - Add new requirements to the risk mitigation option to specify how to present IFIE arising from its application.
- Clarify the wording in paragraph B96(c) of IFRS 17 that sets out requirements for the effects of investment components or policyholder loans unexpectedly paid or unexpectedly not paid.

Overview

At its May 2020 Board meeting, the International Accounting Standards Board (IASB or the Board) considered several sweep issues identified since completion in March 2020 of its planned re-deliberations on the proposed amendments in the Exposure Draft Amendments to *IFRS 17 Insurance Contracts* (the ED).

The story so far

The IASB issued IFRS 17 in May 2017. Our publication, *Applying IFRS 17: A closer look at the new insurance contracts standard,* provides further details on the requirements: http://www.ey.com/Publication/vwLUAssets/ey-Applying-IFRS-17-Insurance-May-18/$FILE/ey-Applying-IFRS-17-Insurance-May-18.pdf

Having considered 25 concerns and implementation challenges arising since *IFRS 17 Insurance Contracts* (IFRS 17 or the standard) was issued, the IASB issued an ED in June 2019 proposing targeted amendments to the standard to respond to some, but not all, of those concerns and challenges: https://www.ifrs.org/projects/work-plan/amendments-to-ifrs-17/#published-documents.

For further details of the IASB's exposure draft, and its subsequent discussions, refer to our recent Insurance Accounting Alerts: https://www.ey.com/gl/en/issues/ifrs.

In finalising the amendments proposed in the ED, the Board identified a number of sweep issues which were discussed at the May Board meeting."

1. Pre-recognition cash flows other than insurance acquisition cash flows

The Board agreed with the staff recommendation to amend paragraph 38 of IFRS 17 to require an entity to include, in the initial measurement of the CSM of a group of insurance contracts, the effect of the derecognition of any asset or liability previously recognised for cash flows related to that group, not just insurance acquisition cash flows. Cash flows related to the group are those that would be included in the fulfilment cash flows of the group on initial recognition if they were paid after, rather than before initial recognition; for example, premiums received before their due date.

This addresses the issue that pre-recognition cash flows for insurance contracts were inadvertently restricted to insurance acquisition cash flows in IFRS 17. The amendment broadens the definition to include other cash flows related to a group of insurance contracts that are paid or received before the group is recognised.

All 14 Board members voted in favour of the staff recommendation, without further discussion.

2. Pre-recognition insurance acquisition cash flows

The Board also agreed to amend the requirements for recognition of an asset for insurance acquisition cash flows in paragraph 28B(b) of IFRS 17. This amendment will include, as an asset, insurance acquisition cash flows for which no cash flows have occurred but a liability has been recognised applying another IFRS standard before the related group of insurance contracts is recognised. Such future cash flows should be included in an asset for insurance acquisition cash flows before the recognition of the group of contracts to which the cash flows relate, and subsequently, in the fulfilment cash flows of the recognised group.

An example would be where an entity has been invoiced for receiving services from a broker relating to a group of contracts not yet recognised, but has not yet paid the invoice.

IFRS 9 *Financial Instruments* requires recognition of the liability for the payments due to the broker.

All 14 Board members voted in favour of the staff recommendation, without further discussion.

3. Reinsurance contracts held – identifying losses on underlying contracts

The IASB agreed with the staff recommendation to add paragraph B119G to IFRS 17. This new paragraph specifies how to determine the recovery of losses from reinsurance contracts held for cases where an entity groups together onerous insurance contracts covered by a reinsurance contract held (referred to as 'underlying contracts') and other onerous insurance contracts not covered by the reinsurance contract.

The amendment will require an entity to use a systematic and rational method to determine the portion of losses recognised for the group of contracts allocated to the underlying insurance contracts (i.e., contract covered by the reinsurance contract). The staff paper also recommended that an entity would use the same systematic and rational method of allocation to determine the portion of subsequent changes in the loss component of the group relating to underlying insurance contracts in the group.

This further change follows the amendment already agreed by the Board to require an entity to recognise in profit or loss the recovery from reinsurance contracts held of losses on underlying insurance contracts on initial recognition, as well as from the requirement in the current version of IFRS 17 to do so subsequently. In order to determine the amount of recovery of such losses, the entity needs to identify the losses on underlying contracts, but is not required to identify or track these losses at a level lower than the group. To separate the losses from underlying insurance contracts and other insurance contracts in a group for the purpose of determining the amount of recovery of losses from reinsurance contracts held could be unduly burdensome.

Observations from the Board meeting

The staff informed the Board of feedback received on the recommendations since the papers were published. Some preparers had informed the staff that they might have more granular information on reinsurance recoveries when underlying contracts were initially recognised, although these preparers mentioned they do not expect to have this level of detail at subsequent measurement dates. Requiring the same method be applied at initial recognition and subsequently could imply that insurers are prohibited from using the more detailed information that is available initially. The staff indicated that such a restriction was not what they had intended and will therefore remove the requirement in the draft wording for the methods to be the same at initial recognition and subsequent measurement.

Two Board members questioned whether it was necessary to specify the use of "a systematic and rational basis" as this might imply that such methods could not be used to make estimates elsewhere in the standard. The staff acknowledged this concern, but felt it was necessary as the requirement to estimate reinsurance recoveries from onerous contracts that are subject to reinsurance, as introduced by the ED, implies that losses would need to be measured at a level lower than the group.

12 of the 14 Board members voted in favour of the staff recommendation.

4. Insurance revenue — income tax

The Board proposes amending paragraph B121 of IFRS 17 to include amounts related to income tax that are specifically chargeable to the policyholder in the list of items that comprise revenue.

Paragraph B121 contains an exhaustive list of the items covered by consideration from a policyholder that determines insurance revenue. The amounts related to the provision of service currently comprise expected insurance service expense, release of the risk adjustment and the CSM. Income tax expense does not form part of insurance service expense. Consequently, the list of the components of revenue is incomplete.

The intended consequence is for an entity to recognise insurance revenue for the consideration paid by the policyholder for such income tax amounts consistent with the recognition of insurance revenue for other incurred expenses applying IFRS 17. Without this amendment, the entity would need to present the amount of consideration related to those income tax expenses as income other than insurance revenue.

All 14 Board members voted in favour of the staff recommendation, without further discussion.

5. Definitions of the liability for remaining coverage (LFRC) and the liability for incurred claims (LFIC)

The IASB agreed with the staff recommendation to amend the definitions of LFRC and the LFIC in Appendix A to IFRS 17 to include all obligations arising from insurance contracts issued by an entity.

The carrying amount of a group of insurance contracts should reflect all of an entity's obligations arising from the group of insurance contracts. However, the definitions of LFRC and LFIC, as proposed in the ED, currently do not provide a complete list of all obligations giving rise to cash flows included in the measurement of the insurance contract liability. For example, other obligations relating to the provision of insurance contract services could include refunds of premiums to the policyholder or expenses payable to third parties. Obligations not related to the provision of insurance contract services could also include some types of investment components.

All 14 Board members voted in favour of the staff recommendation, without further discussion.

6. Variable fee approach — applying the OCI option and the risk mitigation option together

The IASB agreed with the staff recommendation to amend the requirements for the OCI option and risk mitigation option in the variable fee approach (VFA). The risk mitigation option allows an entity to recognise the effect of changes in financial risk on the measurement of fulfilment cash flows of VFA contracts in the statement of profit or loss and OCI instead of adjusting the CSM if certain conditions are met. The IASB agreed to:

- Specify that the accounting policy choice (in paragraphs 88-89 of IFRS 17) to present parts of IFIE in OCI and parts in profit or loss does not apply to IFIE arising from the application of the risk mitigation option
- Add new requirements to the risk mitigation option to specify how to present IFIE arising from its application. This requires an entity to present IFIE in a way that best matches the changes in the mitigating instrument, i.e., the entity would present:
  - Changes in the insurance contract liability that are mitigated using financial assets measured at fair value through profit or loss in profit or loss
  - Changes in the insurance contract liability that are mitigated using reinsurance contracts held applying the same accounting policy for the presentation of IFIE (OCI versus profit or loss) that the entity has chosen for the mitigating reinsurance contracts held

The risk mitigation option allows an entity, provided that certain conditions are met, to recognise the effect of changes in financial risk on the measurement of fulfilment cash flows of VFA contracts in the statement of profit or loss and OCI instead of adjusting the CSM. The question arises as to whether such IFIE items should be recognised in OCI if the entity applies the OCI option permitted by paragraphs 88 and 89 of IFRS 17.

The proposed amendment would prevent the mismatches that can arise from applying the risk mitigation option and the OCI option together by specifying that the IFIE amounts from risk mitigation are treated consistently with the risk mitigating items.

This sweep issue was also discussed by the IASB in April 2019, when the Board decided not to take any action. However, the staff now accepts it is an unintended restriction for an entity not to be able to avoid such a mismatch.

Observations from the Board meeting:

One Board member commented that, even though she was willing to accept the amendment at this stage of the insurance contracts project, providing options in accounting standards can give rise to various difficulties.

All 14 Board members voted in favour of the staff recommendation.

7. Investment components unexpectedly paid or not paid

Paragraph B96(c), as drafted in the ED, required that differences between any investment component or loan to a policyholder expected to become payable, or repayable, in the period and the actual investment component or loan to a policyholder that becomes payable, or repayable, in the period adjusts the CSM, except those described in paragraph B97(a), i.e., differences due to the effect of the time value of money and changes in the time value of money and the effect of financial risk and changes in financial risk.

The IASB staff were concerned that the existing drafting is unclear as to how an entity should consider the effect of financial risks when comparing actual and expected amounts of investment components that become due for repayment in a period. The IASB agreed with the staff proposal to clarify that differences between actual and expected (re)payments are determined by comparing:

(i) the actual investment component or loan to a policyholder that becomes payable or repayable in a period with (ii) the (re)payment in the period that was expected at the start of the period **plus** any IFIE related to that expected payment or repayment before it becomes payable or repayable.

All 14 Board members voted in favour of the staff recommendation, without further discussion.

Next steps:

The staff will continue with the balloting process for the amendments to IFRS 17. We expect that the amendments will be issued towards the end of June 2020.

How we see it:

Whilst most of the sweep issues reflect relatively simple clarifications, a few of the issues represent more important changes, particularly the change regarding applying the OCI option and the risk mitigation option together under the VFA approach and the change regarding the identification of losses on underlying contracts for reinsurance held. The former change takes away an unintended barrier for using the OCI approach when the entity also plans to use the risk mitigation approach. The latter change deals with an important aspect of the recovery of losses through reinsurance held that is fairly common in practice.

Area IFRS Contacts

Global			
	Kevin Griffith	+44 20 7951 0905	kgriffith@uk.ey.com
	Martina Neary	+ 44 20 7951 0710	mneary@uk.ey.com
	Martin Bradley	+44 20 7951 8815	mbradley@uk.ey.com
	Conor Geraghty	+44 20 7951 1683	cgeraghty@uk.ey.com
	Hans van der Veen	+31 88 40 70800	hans.van.der.veen@nl.ey.com
Europe, Middle East, India and Africa			
	Philip Vermeulen	+41 58 286 3297	phil.vermeulen@ch.ey.com
	Thomas Kagermeier	+49 89 14331 25162	thomas.kagermeier@de.ey.com
Belgium	Katrien De Cauwer	+32 2 774 91 91	katrien.de.cauwer@be.ey.com
Belgium	Peter Telders	+32 470 45 28 87	peter.telders@be.ey.com
Czech Republic	Karel Svoboda	+420225335648	karel.svoboda@cz.ey.com
France	Frederic Pierchon	+33 1 46 93 42 16	frederic.pierchon@fr.ey.com
France	Patrick Menard	+33 6 62 92 30 99	patrick.menard@fr.ey.com
France	Jean-Michel Pinton	+33 6 84 80 34 79	jean.michel.pinton@fr.ey.com
Germany	Markus Horstkötter	+49 221 2779 25 587	markus.horstkoetter@de.ey.com
Germany	Robert Bahnsen	+49 711 9881 10354	robert.bahnsen@de.ey.com
Greece	Konstantinos Nikolopoulos	+30 2102886065	konstantinos.nikolopoulos@gr.ey.com
India	Rohan Sachdev	+91 226 192 0470	rohan.sachdev@in.ey.com
Ireland	James Maher	+353 1 221 2117	james.maher@ie.ey.com
Ireland	Ciara McKenna	+353 1 221 2683	ciara.mckenna@ie.ey.com
Italy	Matteo Brusatori	+39 02722 12348	matteo.brusatori@it.ey.com
Israel	Emanuel Berzack	+972 3 568 0903	emanuel.berzack@il.ey.com
Luxembourg	Jean-Michel Pacaud	+352 42 124 8570	jeanMichel.pacaud@lu.ey.com
Netherlands	Hildegard Elgersma	+31 88 40 72581	hildegard.elgersma@nl.ey.com
Netherlands	Bouke Evers	+31 88 407 3141	bouke.evers@nl.ey.com
Portugal	Ana Salcedas	+351 21 791 2122	ana.salcedas@pt.ey.com
Poland	Marcin Sadek	+48225578779	marcin.sadek@pl.ey.com
Poland	Radoslaw Bogucki	+48225578780	radoslaw.bogucki@pl.ey.com
South Africa	Jaco Louw	+27 21 443 0659	jaco.louw@za.ey.com
Spain	Ana Belen Hernandez-Martinez	+34 915 727298	anabelen.hernandezmartinez@es.ey.com
Switzerland	Roger Spichiger	+41 58 286 3794	roger.spichiger@ch.ey.com
Switzerland	Philip Vermeulen	+41 58 286 3297	phil.vermeulen@ch.ey.com
Turkey	Damla Harman	+90 212 408 5751	damla.harman@tr.ey.com
Turkey	Seda Akkus	+90 212 408 5252	seda.akkus@tr.ey.com
UAE	Sanjay Jain	+971 4312 9291	sanjay.jain@ae.ey.com
UK	Brian Edey	+44 20 7951 1692	bedey@uk.ey.com
UK	Nick Walker	+44 20 7951 0335	nwalker1@uk.ey.com
UK	Shannon Ramnarine	+44 20 7951 3222	sramnarine@uk.ey.com
UK	Alex Lee	+44 20 7951 1047	alee6@uk.ey.com

Americas			
Argentina	Alejandro de Navarette	+54 11 4515 2655	alejandro.de-navarrete@ar.ey.com
Brazil	Eduardo Wellichen	+55 11 2573 3293	eduardo.wellichen@br.ey.com
Brazil	Nuno Vieira	+55 11 2573 3098	nuno.vieira@br.ey.com
Canada	Janice Deganis	+1 5195713329	janice.c.deganis@ca.ey.com
Mexico	Tarsicio Guevara Paulin	+52 555 2838687	tarsicio.guevara@mx.ey.com
USA	Evan Bogardus	+1 212 773 1428	evan.bogardus@ey.com
USA	Kay Zhytko	+1 617 375 2432	kay.zhytko@ey.com
USA	Tara Hansen	+1 212 773 2329	tara.hansen@ey.com
USA	Robert Frasca	+1 617 585 0799	rob.frasca@ey.com
USA	Rajni Ramani	+1 201 551 5039	rajni.k.ramani@ey.com
USA	Peter Corbett	+1 404 290 7517	peter.corbett@ey.com
Asia Pacific			
	Grant Peters	+61 2 9248 4491	grant.peters@au.ey.com
	Martyn van Wensveen	+852 3189 4429	martyn.van.wensveen@hk.ey.com
Australia	Kieren Cummings	+61 2 9248 4215	kieren.cummings@au.ey.com
Australia	Brendan Counsell	+61 2 9276 9040	brendan.counsell@au.ey.com
China (mainland)	Andy Ng	+86 10 5815 2870	andy.ng@cn.ey.com
China (mainland)	Bonny Fu	+86 135 0128 6019	bonny.fu@cn.ey.com
Hong Kong	Doru Pantea	+852 2629 3168	doru.pantea@hk.ey.com
Hong Kong	Tze Ping Chng	+852 2849 9200	tze-ping.chng@hk.ey.com
Hong Kong	Steve Cheung	+852 2846 9049	steve.cheung@hk.ey.com
Hong Kong	Martyn van Wensveen	+852 318 94429	martyn.van.wensveen@hk.ey.com
Taiwan	Angelo Wang	+886 9056 78990	angelo.wang@tw.ey.com
Korea	Keum Cheol Shin	+82 2 3787 6372	keum-cheol.shin@kr.ey.com
Korea	Suk Hun Kang	+82 2 3787 6600	suk-hun.kang@kr.ey.com
Malaysia	Jeremy Lin	+60 3 238 89036	jeremy-j.lim@my.ey.com
Philippines	Charisse Rossielin Y Cruz	+63 2 8910307	charisse.rossielin.y.cruz@ph.ey.com
Singapore	Vanessa Lou	+65 6309 6759	vanessa.lou@sg.ey.com
Japan			
	Hiroshi Yamano	+81 33 503 1100	hirishi.yamano@jp.ey.com
	Norio Hashiba	+81 33 503 1100	norio.hashiba@jp.ey.com
	Toshihiko Kawasaki	+81 80 5984 4399	toshihiko.kawasaki@jp.ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. For more information about our organization, please visit ey.com.

© 2020 EYGM Limited. All Rights Reserved.

EYG No. 003595-20Gbl
EY-000120755.indd (UK) 05/20.
Artwork by Creative Services Group London.

ED None

In line with EY's commitment to minimize its impact on the environment, this document has been printed on paper with a high recycled content.

This material has been prepared for general informational purposes only and is not intended to be relied upon as legal, accounting, tax or other professional advice. Please refer to your advisors for specific advice.

This publication contains copyright material of the IFRS® Foundation in respect of which all rights are reserved. Reproduced by EY with the permission of the IFRS Foundation. No permission granted to third parties to reproduce or distribute. For full access to IFRS Standards and the work of the IFRS Foundation please visit http://eifrs.ifrs.org

ey.com