June 2022

Insurance Accounting Alert

IFRS Interpretations Committee issues tentative agenda decision on multi-currency groups of insurance contracts; and finalises agenda decision on IFRS 17 profit recognition

What you need to know

- On 15 June, the IFRS Interpretations Committee (the Committee) discussed a submission regarding the application of *IFRS 17 Insurance Contracts* (IFRS 17) and IAS 21 *The Effects of Changes in Foreign Exchange Rates* (IAS 21) to a group of insurance contracts with foreign currency cash flows.
- The Committee agreed to publish a tentative agenda decision (TAD) for public comment that sets out the applicable requirements in IFRS 17 and IAS 21 and explains:

1. Whether an entity considers currency exchange rate risk when applying IFRS 17 to identify portfolios of insurance contracts.
2. How an entity applies IAS 21 in conjunction with IFRS 17 in measuring a multi-currency group of insurance contracts.

The Committee also discussed comments received on its TAD on profit recognition for annuity contracts issued in March 2022 and agreed to finalise the agenda decision with some minor changes, subject to the IASB not objecting.

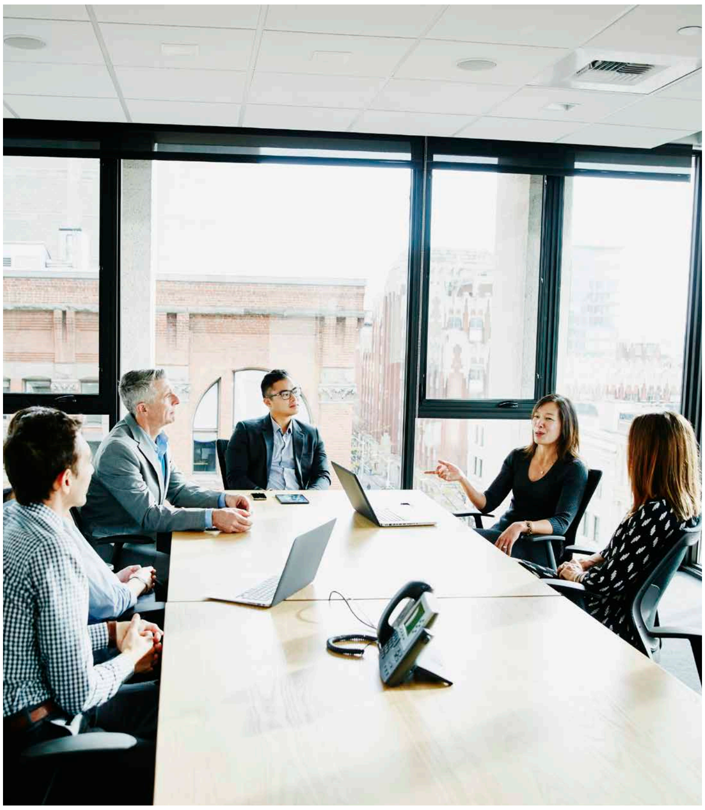
Overview

At its June 2022 meeting, the Committee considered a submission about how to apply IFRS 17 and IAS 21 to a group of insurance contracts with foreign currency cash flows. It also discussed the comments received on the TAD, issued after its March meeting, about how to recognise unearned profit as revenue under IFRS 17 by assessing the services an entity provides to policyholders of annuity contracts and releasing the contractual service margin (CSM).

Background

The Committee is the interpretative body of the International Accounting Standards Board (IASB or the Board). It works with the Board in supporting application of IFRS standards and responds to questions about the application of standards.

In March 2022, the Committee discussed the first submission related to IFRS 17: a question on the interpretation of IFRS 17 regarding the service provided by a life contingent annuity and how to recognise that service through the release of the CSM. The Committee published a tentative agenda decision (TAD) for public comment that set out the applicable requirements in IFRS 17 and explained how an entity determines the quantity of the benefits provided under the group of annuity contracts described in the submission. The Committee discussed the comments received on the TAD in its June 2022 meeting, together with the second submission related to IFRS 17.



The story so far

The IASB issued IFRS 17 in May 2017, it then issued targeted amendments to IFRS 17 in June 2020, following the Exposure Draft (ED) on proposed Amendments to IFRS 17 (published in June 2019 and subsequent re-deliberations based on feedback received on the ED from stakeholders). Our publication, *Applying IFRS 17: A closer look at the new insurance contracts standard (June 2021)*, provides further details on the requirements. The IASB issued a narrow scope amendment to IFRS 17 *Initial Application of IFRS 17* and *IFRS 9—Comparative Information in December 2021*. The Committee considered its first submission related to IFRS 17 in the March 2022 meeting.

1. Multi-currency Groups of Insurance Contracts (IFRS 17 and IAS 21)

The submission, available on the Committee's website, seeks the views of the Committee regarding the application of IFRS 17 and IAS 21 to groups of insurance contracts.

The submission asked three questions:

1. How and when does an entity determine the currency in which an individual insurance contract with cash flows in multiple currencies (a 'multi-currency' contract) is denominated?
2. Is an entity required to consider currency risk when assessing 'similar risks' for the purpose of identifying portfolios of insurance contracts?
3. How does an entity determine the currency in which the CSM of a group of insurance contracts is denominated?

The Committee considered question 2 first, and then question 1 and 3 together.

Establishing a Group of Insurance Contracts

The IASB staff analysis explains that in paragraph 14 of IFRS 17, "similar risks" are not defined. Therefore, all risks should be considered when identifying a portfolio of insurance contracts with similar risks, including both non-financial risks and financial risks (such as currency risk).

Currency risk, therefore, cannot be ignored in the view of the staff. At the same time, the staff observes that IFRS 17 does not always require entities to separate contracts with cash flows in different currencies into different portfolios. Whether or not the risks are "similar risks" will depend on the nature and extent of risks in the entity's contracts.

Measuring a group of insurance contracts with foreign currency cash flows

The IASB staff analysis and the proposed wording in the TAD outlines that an entity could determine a group of contracts, including the CSM, to be denominated in either a single currency or in the multiple currencies of the cash flows of that group. This leads, broadly speaking, to two approaches that were identified during outreach as being adopted by insurers.

Approach 1

The group of insurance contracts (including the CSM) that has cash flows in more than one currency, is denominated in a single currency, such as the currency of the premiums or the predominant cash flows.

The entity fully applies the requirements under IFRS 17 to deal with changes in financial risk when translating cash flows into the single currency of the group, and, where applicable, identifies the group as onerous applying the measurement in that currency. It would, where relevant, apply IAS 21 to translate the carrying amount of the group of contracts, including the CSM, into the functional currency at the end of the reporting period. Paragraph 30 of IFRS 17 states that "when applying IAS 21 to a group of insurance contracts that generate cash flows in a foreign currency, an entity shall treat the group of contracts, including the CSM as a monetary item.

The following illustration, based on the illustration in the staff paper was provided for an entity with EUR functional currency, that has a group of contracts with cash flows in USD and GBP. In the example included by the staff in the paper, the entity determines that the group of contracts is denominated in USD.

Diagram 1: Approach 1

The fulfilment cash flows are denominated in **$ and £**

IFRS 17 applies to the translation from £ to $

The group of contracts (incl. the CSM) is measured in **$**

IAS 21 applies to the translation from $ to €

The group of contracts is translated into the functional currency **€**

Approach 2

the group of insurance contracts (including the CSM) is denominated in multiple currencies, reflecting the currencies of the fulfilment cash flows.

An entity translates the fulfilment cash flows in each foreign currency into its functional currency. It also identifies on initial recognition an amount of CSM relating to each currency and translates each foreign currency amount into its functional currency. Subsequent changes in the cash flows in each foreign currency adjust the amount of the CSM in the respective foreign currency before the adjusted amount is translated into the functional currency. Onerous losses are identified for the entire group in the functional currency.

Diagram 2: Approach 2

Determine the fulfilment cash flows and CSM applying requirements in IFRS 17 in both **$ and £**

IAS 21 applies to the translation from $ and £ to €

Translate all amounts into the functional currency and apply any remaining requirements in IFRS 17 to the group of contracts in **€**

The staff recommended that in measuring a multi-currency group of insurance contracts, an entity should apply all IFRS 17 measurement requirements, including one CSM for the group, and it should treat the group of contracts (including its CSM) as a monetary item under IAS 21. The staff concluded that the two broad approaches identified in outreach could both be applied, depending on the specifics of the contracts within the group.

An entity should develop an accounting policy to determine the currency (or currencies) in which the group—including the CSM—is denominated. The policy should be applied consistently in line with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, the entity cannot simply deem the CSM for the group to be denominated in the functional currency without further consideration as this would fail to treat the CSM as a monetary item per IFRS 17.

The staff recommended not to add a standard-setting project to the work plan, as it considers at this stage that the matter is not sufficiently narrow in scope for the IASB or the Committee to address it in an efficient manner.

Observations from the meeting

Committee members noted that IFRS 17 does not provide specific requirements on how to determine whether risks are similar, and that to try to extend the guidance on this matter, would go to a level of detail beyond that in the standard. Entities need to apply judgment in carrying out (and documenting) an analysis of the risks of insurance contracts.

One Committee member noted that the staff paper refers to respondents to the TAD focusing on risks transferred from the policyholder to the entity, which is slightly different to the wording in the TAD, which says entities must consider foreign currency risk. The Committee member thought the key point is that judgment is needed in determining whether currency is a key assumption, and to emphasise that "similar" does not mean "identical".

Following discussion by the Committee, the staff agreed to update the wording in the TAD to clarify some aspects relevant to Approach 2 and to emphasise that, while there may be elements of the CSM in different currencies, this is purely for the mechanics of Approach 2. These elements are to be brought together to be treated as a single CSM in the functional currency due to the requirement in IFRS 17 to measure a single CSM for a group of insurance contracts.

One Committee member also sought to better clarify the wording in the TAD that an entity cannot "simply deem the CSM for the group to be denominated in the functional currency". The staff agreed that there could be good reasons to have the CSM denominated in the functional currency, but an entity cannot automatically apply the functional currency without appropriate analysis because it could result in ignoring the fact that the insurance liabilities, including the CSM, are considered to be a monetary item.

Several Committee members noted that, under Approach 2, subsequent movements in foreign currency could turn contracts onerous if the CSM in total becomes a debit balance as a result. The staff notes that while it is unusual under IFRS 17 for a change in financial assumptions to make a group onerous, this would be the result of Approach 2 mechanics, and did not consider this could prevent Approach 2 from being applied. One Committee member questioned whether such changes in foreign currency should really turn contracts onerous and be tracked for the purposes of the loss component. Another Committee member noted that entities assess the global profitability of a group of insurance contracts and will not necessarily isolate specific risks when doing so. It was also suggested by a committee member that the impact of changes in foreign currency could be brought out in risk management disclosures. The Committee Chair noted that they should be careful not to extend the scope of the TAD by adding requirements related to onerous contracts and the loss component.

The Committee agreed unanimously with the staff analysis and conclusions regarding considering currency risk when assessing 'similar risks' for the purpose of identifying portfolios of insurance contracts. Thirteen of the fourteen Committee members agreed with the staff analysis and conclusions regarding the application of the requirements in IFRS 17 and IAS 21 to measuring a group of insurance contracts with foreign currency cash flows and agreed to issue a tentative agenda decision with some limited updates of the wording. The Committee also agreed unanimously not to add a standard-setting project to its work plan.

How we see it

- The staff's analysis and the Committee's discussion are useful given the lack of guidance in IFRS 17 and IAS 21 on the treatment of multi-currency groups of insurance contracts and the resulting potential for mixed practices emerging on this topic.
- Respondents to outreach by the IASB staff had noted that, in assessing whether contracts are 'subject to similar risks' when identifying portfolios of contracts under IFRS 17, entities generally focus on risks transferred from the policyholder to the entity under the insurance contracts. However, the Committee observed that adding anything further on what "similar risks" are would go to a level of detail beyond that in the standard and entities therefore need to apply judgment based on the guidance in IFRS 17 in determining similar risk.
- The TAD, if finalised, would allow entities to determine an appropriate accounting policy based on the two broad approaches considered by the Committee, thereby reducing the potential for disruption to ongoing implementations.
- In the meeting material, the staff makes clear it analysed the two approaches in a broad manner. As such, there could be further aspects that are not included in the staff analysis and illustrated in the example in the paper that are relevant to the impact of the currency risks on the measurement of insurance contracts under the two approaches.

Next steps

After the meeting, the Committee published its tentative agenda decision for public comment, with comments due by 19 August 2022. After considering comments received, the Committee will decide at a future meeting whether to confirm its decision and publish a final agenda decision (subject to the IASB not objecting).

2. Transfer of Insurance Coverage under a Group of Annuity Contracts (IFRS 17)

The Committee considered the staff's analysis of the 28 comment letters received on the TAD, issued in March 2022, about the service provided by a life contingent annuity and how to recognise that service through the release of the CSM.

The Committee did not change its technical analysis and conclusions as laid out in the TAD. For further details of the TAD, refer to our March Insurance Accounting Alert.

The Committee decided to confirm its decision and publish a final agenda decision (subject to the IASB not objecting), which means that the "sum assured" method for CSM release (described under Approach B in the March agenda papers) is not a valid interpretation of IFRS 17 principles. The method that the Committee considered in line with the Standard is a release of the CSM on the basis of the claim amount payable in the period (described under Approach A in the March agenda papers).

Once the agenda decision is finalised, entities will need to comply with it. While recognising the concerns of respondents about finalising a TAD so close to implementation, the staff highlighted that the Due Process Handbook states that '*it is expected that an entity would be entitled to sufficient time to determine whether it needs to change an accounting policy as a result of an agenda decision and implement any necessary accounting policy change. Determining how much time is sufficient to make an accounting policy change is a matter of judgement that depends on an entity's particular facts and circumstances.*' An article is available on the IASB's website to help stakeholders determine how much time might be sufficient.

If the Committee were to publish an agenda decision in the second half of 2022 that causes an entity to change or adapt how it is implementing IFRS 17, an entity would not be required to implement the change by 1 January 2023 (i.e., the date of initial application of IFRS 17) if it needs more time to implement the change. However, by publishing the agenda decision before the effective date, entities will have the option to implement any required change within their first financial statements applying IFRS 17 if they choose to do so.

Observations from the meeting

One Committee member continued to disagree with the analysis and conclusion of the proposed agenda decision, noting many respondents shared the same concern, believing that it does not reflect the nature of the contract with the policyholder, and that the agenda decision would be adding to the requirements as currently in IFRS 17.

Other Committee members wanted to assure stakeholders and respondents that they had taken considerable time to work through the comments, but that after doing so, they still agreed with the staff analysis that the conclusion reached is consistent with the requirements of IFRS 17.

The Committee also discussed concerns around timing of the agenda decision, and the need for entities to be allowed sufficient time to adapt their accounting policies where necessary in light of the agenda decision. However, several Committee members, including the Chair, noted that it is beyond the Committee's remit to include a specific date of application in the agenda decision, and that the Due Process handbook already provides guidance in this area.

Twelve of Committee members present at this point agreed with the staff conclusions, and the recommendation to finalise the agenda decision (with some changes to wording as proposed in Appendix A to the staff paper). One Committee member disagreed with finalising the agenda decision.

How we see it

- Some entities will continue to be disappointed by the continued rejection of Approach B, because, as expressed in some comment letters, they believe this view results in a more appropriate reflection of the economics and profitability pattern of these products.
- The agenda decision does now provide clarity to entities, and entities that had planned to adopt Approach B will need to consider any changes needed to their accounting policies and implementation plans, and take note of the guidance provided by the Committee on timing.

Next steps

The IASB will consider the agenda decision at its July 2022 meeting, and if it does not object, the final agenda decision will be published in July.

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