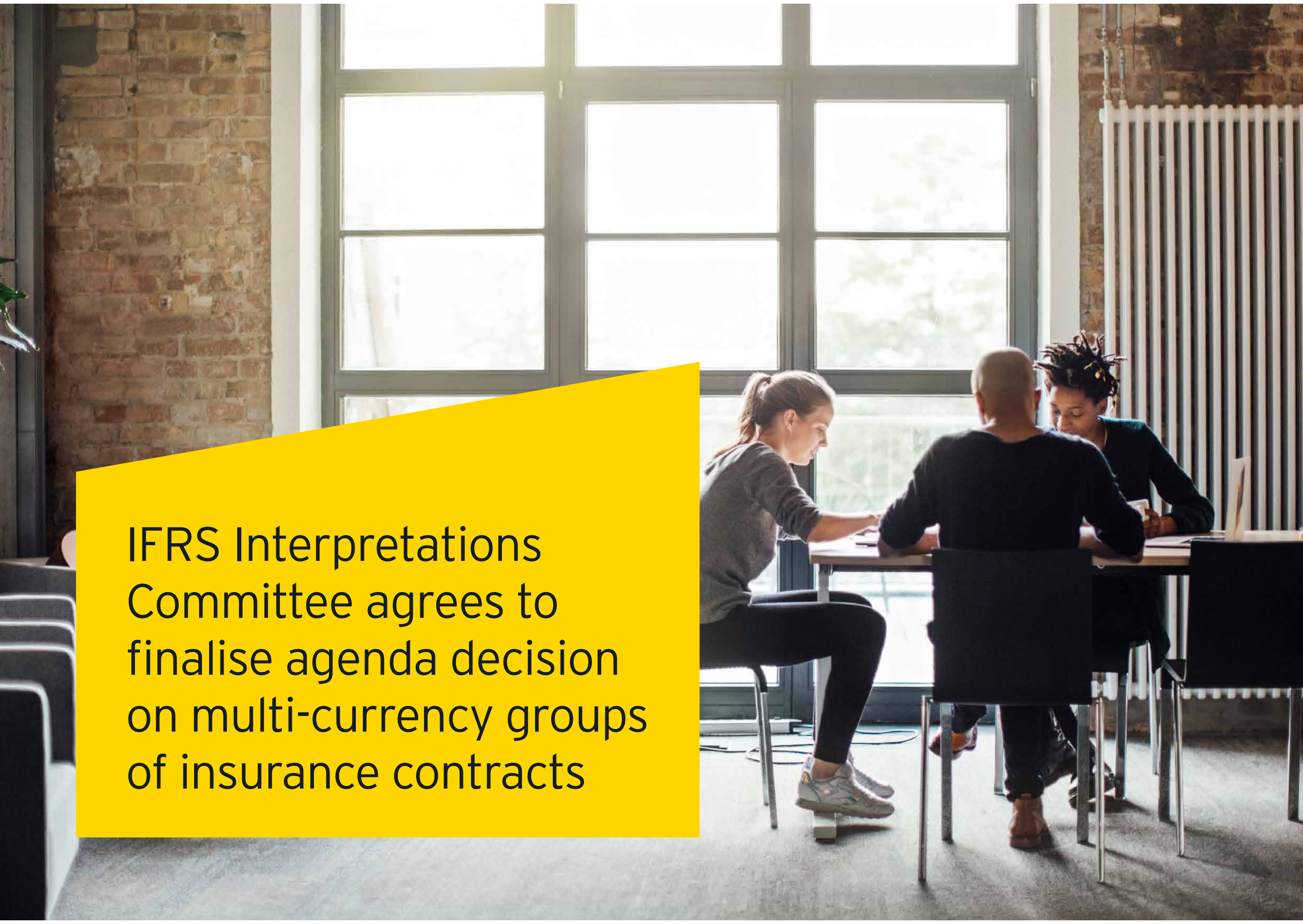
September 2022

Insurance Accounting Alert



IFRS Interpretations Committee agrees to finalise agenda decision on multi-currency groups of insurance contracts

What you need to know

- On 13 September 2022, the IFRS Interpretations Committee (the Committee) discussed comments received on its tentative agenda decision (TAD) on 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 that generates cash flows in more than one currency.
- The Committee did not change its technical analysis and conclusions as laid out in the TAD. The Committee agreed to two changes to the TAD, proposed by the staff, to address points raised in the comment letters.
- The Committee agreed to finalise the agenda decision, subject to the two changes and some additional improvements to the wording, and subject to the IASB's agreement.

Overview

At its September 2022 meeting, the Committee discussed the comments received on the TAD, issued after its June meeting, where it considered a submission about how to apply IFRS 17 and IAS 21 to a group of insurance contracts with foreign currency cash flows.

Background

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

In June 2022, the Committee discussed its second submission relating to IFRS 17, about how to apply IFRS 17 and IAS 21 to a group of insurance contracts with foreign currency cash flows, and subsequently issued a TAD for public comment.

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 *International GAAP®* ,which is updated annually, 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 issued its first agenda decision related to IFRS 17 in July 2022: *Transfer of Insurance Coverage under a Group of Annuity Contracts (IFRS 17 Insurance Contracts)*, which relates to 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.

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

At its June 2022 meeting, the Committee discussed its TAD on multi-currency groups of insurance contracts. The Committee addressed the following two questions regarding how to account for multi-currency groups of insurance contracts:

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

Further details on the TAD are available in our June 2022 Insurance Accounting Alert.

September Committee meeting

At its September meeting, the Committee considered the **staff's analysis** of the 18 comment letters received on the TAD regarding the application of IFRS 17 and IAS 21 to groups of insurance contracts.

Identifying portfolios of insurance contracts

In the TAD, the Committee concluded that under IFRS 17 an entity is required to consider all risks – including currency exchange rate risks – when identifying portfolios of insurance contracts, but that 'similar risks' does not mean 'identical risks'. The Committee argued that an entity could, therefore, identify portfolios of insurance contracts that include contracts subject to different currency exchange rate risks within the same portfolio if it judges these to be similar risks.

Respondents largely agreed, or did not disagree, with the Committee's conclusions.

One respondent expressed concern that the level of aggregation may be set inappropriately high if, in addition to the risks the contract transfers from the policyholder, other risks have to be taken into consideration if deemed to be similar across different types of contracts. Examples given were lapse risk and expense risk. However, the Committee disagreed that such risks might lead to inappropriately high levels of aggregation, since not all risks will have the same effect on the assessment and all risks will need to be considered together.

The staff analysis also considered a question on whether the requirement to consider 'all risks' applies to risks the entity is exposed to before or after 'mutualisation'. The respondent was concerned that to do so after 'mutualisation' could lead to very different contracts being viewed as having similar risks and managed together, if they share in the same pool of underlying items. The analysis in the staff paper explains that facts and circumstances determine the risks in an insurance contract and that entities will use different techniques to share risks and returns between policyholders and shareholders. The staff also noted that the fact pattern in the submission did not include information on this and believed the Committee would not be in a position to conclude on whether 'similar risks' should always be considered before or always after 'the effect of 'mutualisation' as part of this submission.

The Committee did not change its technical analysis and conclusions as laid out in the TAD.

Developing a multi-currency accounting policy

The Committee proposed in the TAD that the entity, applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, develops an accounting policy to determine on initial recognition, the single currency, or multiple currencies in which a group, including the CSM, is denominated. The TAD broadly identified two approaches for measuring multi-currency groups of insurance contracts:

- Single-currency accounting policy' — the group of insurance contracts (including the CSM) is considered to be denominated in a single currency. If that single currency is a foreign currency, the entity then applies IAS 21 and translates the carrying amount of the group of contracts into its functional currency at the end of each reporting period.
- 'Multi-currency accounting policy' — the group of insurance contracts (including the CSM) is considered to be denominated in multiple currencies, reflecting the currencies of the fulfilment cash flows. An entity applies IAS 21 and translates the fulfilment cash flows in each foreign currency into its functional currency. It also identifies on initial recognition an amount of the CSM relating to each currency and translates each foreign currency amount from the foreign currency into its functional currency.

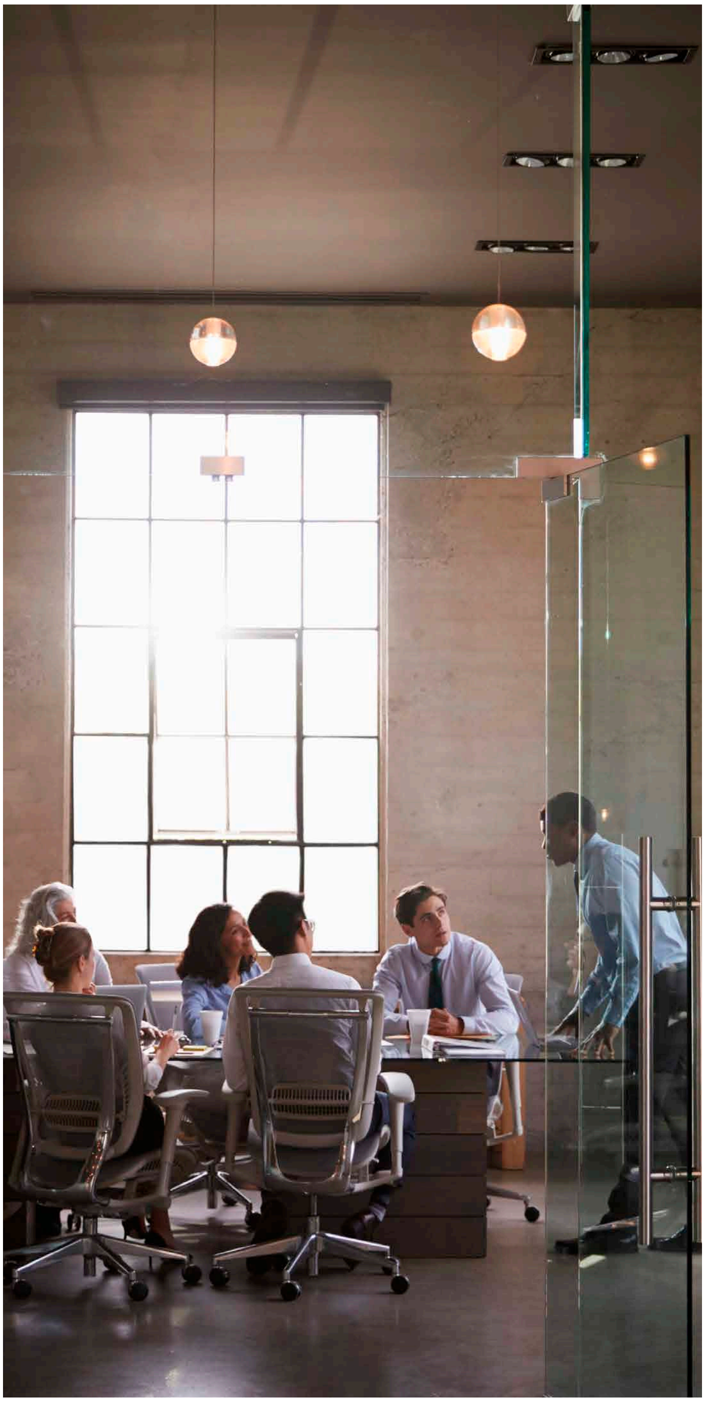
All respondents agreed with the approach of a single-currency accounting policy. Several respondents expressed concerns, or asked questions, about an entity developing a multi-currency accounting policy.

The staff analysis prepared for the meeting considered a number of comments and focused on the following topics:

The effect of changes in financial risk accounted for applying IFRS 17 and exchange differences accounted for applying IAS 21

The staff addressed respondents' concerns that the multi-currency accounting policy would not comply with paragraph B97(a)(i) of IFRS 17, which requires that the CSM is not adjusted for changes in financial risk. The staff argued that the TAD states that the accounting policy selected determines how an entity calculates exchange differences in IAS 21, since the accounting policy determines the currency, or currencies, from which the entity translates amounts into the functional currency. These exchange differences arise from IAS 21 and do not form part of the accounting under IFRS 17. Only changes in exchange rates not accounted for under IAS 21 are changes in financial risk in IFRS 17.

The Committee agreed to update the agenda decision accordingly. The wording will clarify that the accounting policy regarding the currency, or currencies, the group of contracts is denominated in determines which effects of changes in exchange rates are exchange differences applying IAS 21 and which effects of changes in exchange rates are changes in financial risk applying IFRS 17.



The CSM represents the unearned profit and not the unearned losses of a group of contracts

The staff addressed respondents' concerns that application of the multi-currency accounting policy could cause the CSM of the group of contracts to become negative when translating the CSM amounts in foreign currencies into the functional currency following IAS 21.

The staff analysis noted that IFRS 17 does not contain specific requirements regarding situations when exchange differences cause the CSM to become negative. However, because the CSM represents the unearned profits of the group of contracts, the principles, and requirements in IFRS 17 mean the carrying amount of the CSM of the group of contracts must be a positive amount and cannot be negative. As the effect of exchange differences causing the CSM becoming negative is not caused by an unfavourable change in the fulfilment cash flows, the related loss is not an onerous loss under IFRS 17 and there is no loss component. IFRS 17 includes no requirements about where to present this loss.

The Committee did not change its technical analysis and conclusions as laid out in the TAD, but agreed to amend the wording of the agenda decision to reflect that the CSM represents the unearned profit the entity will recognise as it provides insurance contract services. The agenda decision will also make clear that the entity would prevent the carrying amount of the CSM being negative by, when necessary to do so, recognising a loss.

Observations from the meeting

One Committee member commented that if a loss is recognised as a result of exchange differences in the CSM under the multi-currency accounting policy, it would go beyond the requirements in IFRS 17 to state that this loss could only be recognised in the statement of profit or loss. The wording in the agenda decision will be updated to reflect this.

Some Committee members raised questions on more detailed methodological issues, such as the discount rates to accrete interest on, and to measure changes in, the CSM. The staff commented that to include further detail on such methodological matters in the agenda decision would go beyond the question raised in the submission and would also go beyond what is written in IFRS 17.

One Committee member also commented that further information on presentation would be useful. However, the staff noted that the accounting policy developed for multi-currency contracts will determine which effects of changes in exchange rates are treated as insurance finance income or expenses under IFRS 17 and which effects of changes in exchange rates are IAS 21 exchange differences. The staff added that the guidance on presentation in applicable standards should be applied to these items.

The Committee chair highlighted the need to be conscious of the timing of this agenda decision, and the risk that trying to delve into such mechanical issues could cause unintended disruption to implementations already underway.

All fourteen Committee members present agreed to finalise the agenda decision, including the changes to the wording mentioned above and subject to some additional changes.

How we see it

- The analysis in the agenda decision will be useful given the lack of specific guidance in IFRS 17 and IAS 21 on the treatment of multi-currency groups of insurance contracts, and the resulting potential for mixed practices.
- The Committee's response to the comments raised regarding similar risks confirms that judgement plays an important part in determining similar risks and identifying portfolios of insurance contracts and that no further guidance or clarifications will be added beyond what is already included in the TAD on this matter.
- The Committee focused on addressing the main issues, particularly concerns raised regarding the treatment of a negative CSM under a multi-currency policy. However, the Committee felt it should not address the more detailed mechanical issues, and this was also echoed in the Committee chair's reminder of the timing of this agenda decision and risk of unintended disruption to ongoing implementations. Entities will need to determine in more detail how to implement the currency accounting policies following the principles set out in the agenda decision.

Next steps

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

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EYG no. 008213-22Gbl
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