Building a better working world

Insurance Accounting Alert

June 2018

IASB proposes narrow-scope amendments to IFRS 17 *Insurance Contracts*

What you need to know

- The IASB agreed to staff proposals to include several minor changes to IFRS 17 in its next Annual Improvements Cycle. These narrow-scope amendments address instances where the drafting of IFRS 17 did not achieve what the Board intended.
- One change will clarify that investment-related services are to be considered in determining the coverage period for allocation of the contractual service margin to profit or loss for contracts with direct participation features (accounted for under the variable fee approach). This change does not apply to contracts accounted for under the general model or the premium allocation approach.
- The IASB clarified that the requirements in IFRS 17 on how to account for insurance contracts acquired in a business combination do not apply to business combinations between entities under common control.
- The requirement to assess on acquisition date whether contracts acquired in a business combination are insurance contracts will apply only to business combinations that occur after the date of initial application of IFRS 17.
- In addition, the Board agreed to six other amendments.

Overview

During its June meeting, the International Accounting Standards Board (IASB or the Board) discussed and agreed to several proposed narrow-scope amendments to IFRS 17 *Insurance Contracts* (IFRS 17). These minor changes are intended to ensure the wording of the standard is consistent with the decisions that the IASB made in the development of the standard.

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[1]

The cover note and papers for the June meeting, which include an overview of IFRS 17 requirements are available on the IASB's website[2]

[1] http://www.ey.com/Publication/vwLUAssets/ey-Applying-IFRS-17-Insurance-May-18/$FILE/ey-Applying-IFRS-17-Insurance-May-18.pdf

[2] https://www.ifrs.org/news-and-events/calendar/2018/june/international-accounting-standards-board/

Proposals for narrow-scope amendments to IFRS 17

The IASB discussed several minor instances, identified since IFRS 17 was published in May 2017, where the drafting of the standard does not achieve what the Board intended. The Board agreed to include changes to address these points in the next *Annual Improvements to IFRS Standards Cycle* (the Annual Improvements Cycle). This cycle is limited to narrow-scope amendments that clarify the wording in a standard or correct relatively minor unintended consequences, oversights or conflicts between existing requirements of the standard.

Coverage period for insurance contracts with direct participation features

The staff proposed an amendment to the definition of the coverage period for insurance contracts with direct participation features accounted for under the Variable Fee Approach (VFA). The amendment clarifies that the coverage period for these contracts includes periods in which the entity provides investment-related services. The Board spent more time discussing this point than the other proposed changes, noting that the issue was raised at the May 2018 Transition Resource Group for IFRS 17 (TRG). At that meeting, TRG members expressed different views on both the need for and scope of the proposed change.

IFRS 17 requires the contractual service margin to be allocated over the coverage period of a group of contracts on the basis of coverage units. Coverage units are a measure of the quantity of coverage provided by the contracts in the group determined by considering the quantity of benefits provided and expected coverage duration[3]. The staff proposed a change to address uncertainty about how "the quantity of benefits" referred to in paragraph B119(a) should be defined when considering contracts with an investment component.

The staff believe the requirements of IFRS 17 differ for contracts with direct participation features, accounted for under the VFA, and insurance contracts without direct participation features, accounted for under the general model or the premium allocation approach.

VFA contracts apply a modified approach of the accounting requirements because they are substantially investment-related service contracts. As such, references to *"services"*, *"quantity of benefits" and "expected coverage duration"* for these contracts relate to both insurance and investment-related services. To make this principle clear, the proposed amendment modifies the definition of coverage period for VFA contracts to be *"the period during which the entity provides coverage for insured events or investment-related services"*.

This amendment does not apply to contracts accounted for under the general model even if these contracts have an investment component. The staff believe that coverage period for these contracts should be determined only by reference to the period during which the entity provides coverage for insured events.

One Board member disagreed with the proposal, arguing that this was more than a minor amendment suitable for the annual improvements cycle, and that it warranted wider discussion and debate. The Board member expressed concern about the "cliff effect" between contracts accounted for under the VFA approach and contracts with participation features that are within the scope of the general model. The Board member thought this could result in a counter-intuitive outcome for allocation of the CSM for contracts that are arguably similar in nature. In the view of the Board member, rather than addressing this issue as an annual improvement now, it would be better to consider the application of coverage units to investment-related services more broadly as part of a post-implementation review.

The other Board members agreed with the staff proposal as it addresses an oversight in the drafting of the standard that needs clarification in order for the VFA model to work as the Board intended. The Board members also agreed not to include any amendments to the definition of coverage units for contracts accounted for under the general model as part of an annual improvement cycle as it would be more substantive than a narrow-scope amendment. However, Board members indicated that concerns about the outcome for contracts under the general model with investment components could be considered by the Board at a later stage, as part of a broader evaluation of concerns raised by the TRG.

Business combinations

A change was proposed to clarify that business combinations between entities under common control are exempted from the requirements for accounting for insurance contracts acquired in a business combination in IFRS 17. The Board never intended such transactions to be in the scope of IFRS 17, but paragraph 39 and B93-95 of IFRS 17 which deal with these requirements do not explicitly exclude common control transactions. As such, the proposed amendments explicitly exclude such business combinations.

IFRS 17 amended IFRS 3 *Business Combinations* to clarify that assessment of whether or not contracts acquired in a business combination are insurance contracts should be based on the terms and conditions that exist at the acquisition date. The proposed change clarifies that this amendment is intended to apply only to business combinations that occur after the date of initial application of IFRS 17.

All Board members agreed with these amendments.

[3] IFRS 17 paragraph B119

Other proposed changes:

All Board members agreed with the staff recommendation to propose six other minor amendments to IFRS 17 in the next Annual Improvements Cycle. The amendments are summarized below:

- **Amendment to IFRS 17 paragraph 27 to include acquisition cash flows relating to insurance contracts in the group that have not yet been issued.** This corrects any unintended consequences of the use of the term "issued" in the paragraph which was meant to distinguish between insurance contracts issued by the entity as insurer as opposed to reinsurance contracts held, rather than to exclude cash flows relating to contracts yet to be issued.
- **Amendment to IFRS 17 paragraph 28 (and a consequential amendment in IFRS 17 paragraph 24)** to achieve the intended timing of recognition of contracts within the group. The paragraph sets out how to recognize a group when contracts qualify for recognition over more than one reporting period. The paragraph should refer to "contracts that meet the criteria for recognition in paragraph 25" rather than to "contracts issued by the end of the reporting period".
- **Removal of potential double counting of the risk adjustment for non-financial risk in the insurance contracts reconciliation disclosures and revenue analysis.** IFRS 17 paragraph 104, B121 and B124 disclosure requirements identify the risk adjustment for non-financial risk separately, but some risk adjustment for non-financial risk could be captured in other disclosure components in those paragraphs. Changes in the risk adjustment for non-financial risk relating to current service could be duplicated. The proposed amendment clarifies this by excluding changes in the risk adjustment from the other disclosure components.
- **Correction of the terminology in the sensitivity analysis disclosures.** This is to correct the inadvertent use in IFRS 17 paragraphs 128 and 129 of the term "risk exposure" rather than "risk variable".
- **Amendments to IFRS 7 *Financial Instruments-disclosures (IFRS 7), IFRS 9 Financial Instruments (IFRS 9) and IAS 32 Financial Instruments – presentation* (IAS 32) to achieve the intended interaction between the scopes of these financial instrument standards and the scope of IFRS 17, particularly with respect to insurance contracts held.** The scope paragraphs of IFRS 7, IFRS 9 and IFRS 32 were originally amended when IFRS 17 was issued to refer to IFRS 17 rather than IFRS 4 *Insurance contracts*. However, the original amendment inadvertently removed the scope exception for insurance contracts held, by referring only to insurance contracts in the scope of IFRS 17 rather than the broader population of insurance contracts as defined in IFRS 17. The proposed amendment corrects this.
- **Addition of an explanation in Example 9 of the Illustrative Examples on IFRS 17 that the time value of the guarantee changes over time** This change was made to Example 9 because the IASB staff realised that readers of IFRS 17 were having difficulty understanding the example without an indication of what factors had been included.

How we see it

The amendments provide helpful clarification. In particular, it is now clear that for VFA contracts, entities must assess the pattern of the provision of both insurance services and investment-related services in order to release the CSM to income over the coverage period.

However, this change does not apply to contracts accounted for under the general model. It was clear from the May 2018 TRG meeting that a number of TRG members were concerned about the usefulness of the information reported on the allocation of the contractual service margin to profit or loss for contracts not in the scope of the VFA if the coverage units for those contracts could not include both insurance and investment-related services. Some types of contracts may contain an investment component, but do not qualify for the VFA. For these contracts, the CSM on initial recognition will partly be determined by profits that arise from any investment services. However, the release of that CSM will consider the pattern of insurance services only. If the timing of provision of these other services differs from the provision of the insurance service on these contracts, then the CSM release will be limited to the period of insurance coverage only.

The Board's clarification that business combinations between entities under common control are exempted from the requirements in IFRS 17 allows an entity to apply predecessor accounting for these transactions. This will be welcomed by many preparers as entities conduct intra-group transactions, to which predecessor accounting is typically applied in order to avoid remeasurements under IFRS 3.

Next steps

The publication date of the annual improvements outlined above will depend on other matters identified for inclusion in the next Annual Improvements Cycle.

The next TRG meeting will take place in September 2018, and the IASB and staff will continue to monitor whether additional action is needed as implementation of IFRS 17 progresses. They will monitor factors affecting implementation such as the implementation timetable.

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
Czech Republic Karel Svoboda	+420 225 335 648	karel.svoboda@cz.ey.com
France Frederic Pierchon	+33 1 46 93 42 16	frederic.pierchon@fr.ey.com
Germany Markus Horstkötte	+49 221 2779 25 587	markus.horstkoetter@de.ey.com
Germany Robert Bahnsen	+49 711 9881 10354	robert.bahnsen@de.ey.com
Greece and Turkey Konstantinos Nikolopoulos	+30 21 0 288 6065	konstantinos.nikolopoulos@gr.ey.com
India Rohan Sachdev	+91 226 192 0470	rohan.sachdev@in.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
Netherlands Jasper Kolsters	+31 88 40 71218	jasper.kolsters@nl.ey.com
Portugal Ana Salcedas	+351 21 791 2122	ana.salcedas@pt.ey.com
Poland Marcin Sadek	+48 225 578 779	marcin.sadek@pl.ey.com
Poland Radoslaw Bogucki	+48 225 578 780	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
SwitzerlandRoger Spichiger	+41 58 286 3794	roger.spichiger@ch.ey.com
Switzerland Philip Vermeulen	+41 58 286 3297	phil.vermeulen@ch.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	+1 519 5713 329	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

Jonathan Zhao	+852 6124 8127	jonathan.zhao@hk.ey.com
Martyn van Wensveen	+60 3 749 58632	martyn.van.wenveen@my.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 Peter Telders	+852 9666 2014	peter.telders@hk.ey.com
Taiwan Angelo Wang	+86 186 1190 9655	angelo.wang@ch.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 Martyn van Wensveen	+60 3 749 58632	martyn.van,wensveen@my.ey.com
Malaysia Jeremy Lin	+60 3 238 89036	jeremy-j.lim@my.ey.com
Philippines Charisse Rossielin Y Cruz	+63 2 891 0307	charisse.rossielin.y.cruz@ph.ey.com
Singapore Patrick Menard	+65 6309 8978	patrick.menard@sg.ey.com
Singapore Sumit Narayanan	+65 6309 6452	sumit.narayanan@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

Notes

Notes

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. For more information about our organization, please visit ey.com.

About EY's Global Insurance Sector
Insurers must increasingly address more complex and converging regulatory issues that challenge their risk management approaches, operations and financial reporting practices. EY's Global Insurance Sector brings together a worldwide team of professionals to help you succeed — a team with deep technical experience in providing assurance, tax, transaction and advisory services. The Sector team works to anticipate market trends, identify their implications and develop points of view on relevant sector issues. Ultimately, this team enables us to help you meet your goals and compete more effectively.

EYG No. 03848-183Gbl

EY-000068189.indd (UK) 06/18.
Artwork by Creative Services Group Design.

ED None

ey.com