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

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AD *Multi-currency groups of insurance contracts (IFRS 17 and IAS 21)*

What is an agenda decision?

Agenda decisions are published when the IFRS Interpretations Committee (IFRS IC) decides that a standard setting project should not be added to their work plan. An agenda decision:

Agenda decision

- Explains how the relevant principles and requirements in IFRS apply to the transaction or fact pattern described in the submission sent to the IFRS IC by a stakeholder. Stakeholders' identity is not shared with the public.
- Derives its authority from the IFRS pronouncements and cannot add or change the existing requirements.
- Must be reflected when applying the IFRS/IAS discussed in the AD and may result to a change in an entity's accounting policy.
- Does not include an effective date and judgement should be applied in determining how much time is sufficient to make an accounting policy change (depends on facts and circumstances of the entity).

AD *Multi-currency groups of insurance contracts (IFRS 17 and IAS 21)*

Overview

There are a number of scenarios that can be observed in the insurance market where insurance contracts have ***cash flows in multiple currencies***:

Scenario 1

Home Office
UK

Branch
Germany

Insurance contracts* have all of their cash flows in **Pound sterling**

Insurance contracts* have all of their cash flows in **Euro**

Scenario 2

Insurance contracts issued have cash flows denominated in multiple currencies, for example:

- Premiums: **Euro**
- Claims:
    - **Euro**
    - **US Dollar**

Scenario 3

Insurance company with **Euro** as functional currency:

issues insurance contracts with premiums and claims in **Euro**

incurs policy administration costs in **Pound sterling**

*Assuming contracts have identical terms and conditions. Only the currencies, as indicated in the fact pattern, are different.

AD *Multi-currency groups of insurance contracts (IFRS 17 and IAS 21)*

Overview (cont'd)

Relevant IFRS requirements when measuring group of insurance contracts with cash flows in a **single foreign currency** are as follow:

- **IFRS 17:30** requires to "…treat the group of contracts, including the contractual service margin, as a **monetary item**" when applying IAS 21*.

- **IAS 21:21-24** requires an entity:
  a) to recognise a foreign currency transaction in the **functional currency** at the **spot exchange date** at the date of the transaction;
  b) to determine the **carrying amount of a monetary item** in conjunction with other **relevant accounting standards**; and
  c) to **translate** foreign currency **monetary items** into the **functional currency** using the closing rate at the end of each reporting period.

However, neither of these requirements nor other IFRS Accounting Standards explicitly provide requirements on how to determine the currency denomination of transactions or items with cash flows in **more than one currency**.

* IAS 21, *The Effects of Changes in Foreign Exchange Rates*

AD *Multi-currency groups of insurance contracts (IFRS 17 and IAS 21)*

Overview (cont'd)

The AD on *Multi-currency Groups of Insurance Contracts (IFRS 17 and IAS 21)* addresses the following **implementation questions** when accounting for insurance contracts with cash flows in multiple currencies:

- whether an entity **considers currency exchange rate risks** when applying IFRS 17 **to identify portfolios** of insurance contracts; and
- how an entity applies IAS 21 in conjunction with IFRS 17 in **measuring** a group of insurance contracts with **cash flows in more than one currency** (a multi-currency group of insurance contracts).

IFRS IC **approved** the AD for finalisation on 13 September 2022 and was discussed by the International Accounting Standards Board (IASB) on 19 October 2022 **with no objections on the publication** of the AD.

The key points in the AD include:

- in **identifying portfolios** of insurance contracts:
  - all risks, ***including* currency risk**, shall be considered when identifying portfolios of contract
  - portfolios could still include contracts subject to **different currency exchange rate risks**

AD *Multi-currency groups of insurance contracts (IFRS 17 and IAS 21)*

Overview (cont'd)

The key points in the AD include (*cont'd*):

- in measuring multi-currency group of insurance contracts:
    - apply **all measurement requirements** in IFRS 17 and treat the group of contracts, including the contractual service margin (CSM), as a **monetary item**
    - there is a **single CSM** for the group of insurance contracts
    - denomination of the CSM currency for the group of contracts **cannot simply be presumed** to be the **functional currency**
    - use judgement **to develop and apply an accounting policy in accordance with IAS 8^** that determines on initial recognition the currency denomination of the group, including the CSM

^ IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*

AD *Multi-currency groups of insurance contracts (IFRS 17 and IAS 21)*

Identifying portfolios of insurance contracts

IFRS 17 requires the following steps when establishing groups of insurance contracts:

01

Identify portfolios of insurance contracts

A portfolio comprises contracts subject to **similar risks** and managed together.

02

Group by annual cohort

Contracts issued **12 months (or less) apart**.

03

Group by profitability [1]

Minimum of **three group of contracts** that are (if applicable):

a. onerous at initial recognition;
b. have no possibility becoming onerous subsequently;
c. other contracts

[1] Entities are permitted to subdivide groups further than the minimum required.

Should an entity consider currency exchange rate risks when applying IFRS 17 to identify portfolios of insurance contracts?

AD *Multi-currency groups of insurance contracts (IFRS 17 and IAS 21)*

Identifying portfolios of insurance contracts (cont'd)

IFRS 17:14 refers to '**similar risks**' without specifying the types of risk to consider, thus all risks shall be considered when identifying portfolios of contract ***including* currency risk**[2].

Portfolios could still include contracts subject to different currency exchange rate risks as **'similar' does not mean 'identical'.**

What an entity considers to be 'similar risks' will depend on the **nature and extent of the risks** in the entity's insurance contracts.

[2] IFRS 17 Appendix A defines financial risk to include *"risk of a possible future change in… **currency exchange rate**…"*

AD *Multi-currency groups of insurance contracts (IFRS 17 and IAS 21)*

Measuring a multi-currency group of insurance contracts (cont'd)

There are the two **approaches** considered in the AD for measuring a multi-currency group of insurance contracts.

Approach 1: Single-currency denomination approach

Fulfilment cash flows (FCF) are denominated in more than one currency

Effect of currency exchange differences on the contractual service margin [IFRS 17:44(d)] b

Group (incl. CSM) is measured using the identified single currency with which the group is denominated a

Exchange difference [IAS 21:23(a)] c

Group is translated into the functional currency at reporting date

a — A single currency in which the group of contracts is denominated is determined (e.g. currency of the premium, currency of the predominant cash flow).

b — All changes in exchange rates between the currency of the cash flows and the currency that denominates the group of contracts are treated as changes in financial risk applying IFRS 17

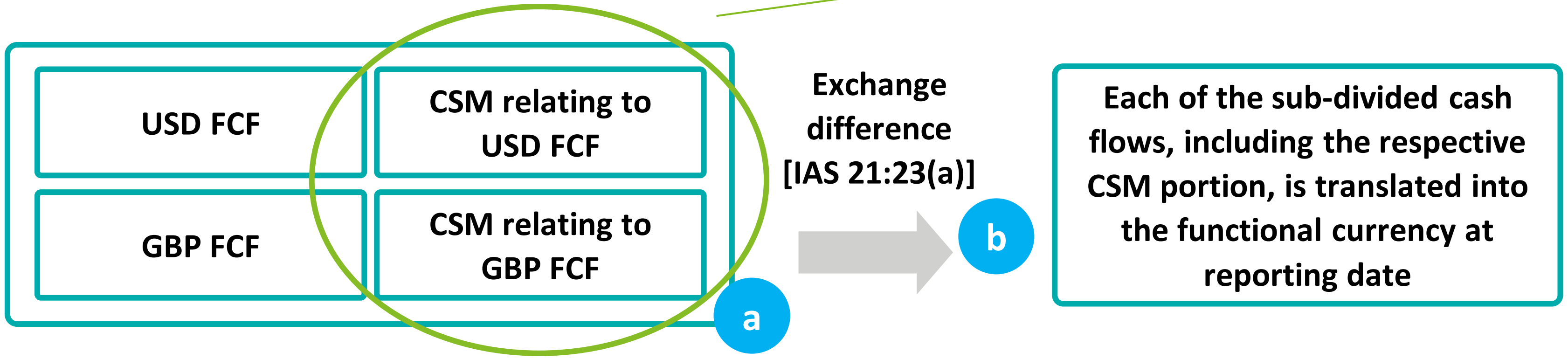
c — All changes in exchange rates between the currency of the group of contracts and the functional currency are treated as exchange differences applying IAS 21

AD *Multi-currency groups of insurance contracts (IFRS 17 and IAS 21)*

Measuring a multi-currency group of insurance contracts (cont'd)

Approach 2: Multi-currency denomination

Two portions of CSM is a technique to translate foreign currency to the functional currency of the entity.



a — CSM is determined for each of the sub-divided fulfilment cash flows at initial recognition. Each of the CSM portions are subsequently adjusted separately for changes in the associated foreign currency cash flows and for the respective allocation to insurance services for the period. Then, the entity aggregates all the portions of the CSM into a single CSM balance.

b — All changes in exchange rates between the currency of the sub-divided cash flows, including the foreign currency denominated portions of the CSM, and the functional currency are treated as exchange differences applying IAS 21.

Illustrative Example

Measuring a multi-currency group of insurance contracts (cont'd)

Fact pattern

- At the beginning of Year 1, Entity X issues a group of insurance contracts with a three-year coverage period and cash flows in different currencies.
- Premiums are received at the start of each period and claims paid at the end of each period.
- Insurance coverage is provided evenly over the three-year coverage period. Summarised below are the expected future cash flows generated by the group.

	Year 1	Year 2	Year 3	Total
Premiums (US$)	400	400	400	1,200
Claims (US$)	(100)	(100)	(100)	(300)
Claims (£)	(300)	(250)	(200)	(750)

The illustrative example is based on the Appendix B – Illustrative Example of June 2022 IFRS IC Meeting Agenda Paper 6.

Illustrative Example

Measuring a multi-currency group of insurance contracts (cont'd)

Fact pattern (*cont'd*)

- The exchange rates for each currency are as follows:

	At recognition	End of Year 1	Average
US$1	£0.86	£0.85	£0.86
US$1	€0.95	€1.00	€0.98
£1	€1.11	€1.18	€1.15

- The entity's functional currency is Euro (€).

- For simplicity, actual equals that expected at initial recognition. Time value of money and risk adjustment for non-financial risks are also ignored.

How should an entity apply IAS 21 in conjunction with IFRS 17 in measuring a group of insurance contracts that generate cash flows in more than one currency?

Illustrative Example

Measuring a multi-currency group of insurance contracts (cont'd)

Using single-currency denomination approach

The table shows how the carrying amounts of the fulfilment cash flows and the CSM are calculated at **initial recognition**:

Items:	IFRS 17 amounts are determined in:		Amounts are translated applying IAS 21 into:	
		$		**€**
Fulfilment cash flows				
Premiums ($)		1,200.0 Dr		
Claims ($)		(300.0) Cr		
Claims (£)	750 x (1 ÷ 0.86)	(872.1) Cr		
		27.9 Dr	(27.9 x 0.95)	**26.5 Dr**
CSM		(27.9) Cr		**(26.5) Cr**

The group of contracts is determined to be denominated in US$ ("group currency")

The fulfilment cash flows in £ is translated to the group currency of US$

Dr = Debit balance

Cr = Credit balance

Illustrative Example

Measuring a multi-currency group of insurance contracts (cont'd)

Using single-currency denomination approach (cont'd)

The table below shows the change in the **carrying amount of the fulfilment cash flows** at the end of Year 1:

Items:	IFRS 17 amounts are determined in:		Amounts are translated applying IAS 21 into:	
		$		€
Opening balance		–		–
Contracts issued @ Y1		27.9 Dr		26.5 Dr
Premiums received ($)		(400.0) Cr	(400 x 0.95)	(380.0) Cr
Claims paid ($)		100.0 Dr	(100 x 1)	100.0 Dr
Claims paid (£)	300 x (1 ÷ 0.85)	352.9 Dr	(352.9 x 1)	352.9 Dr
Closing balance (A)		**80.8 Dr**		**99.4 Dr**
IFIE (C)	(B – A)	(10.2) Cr	(10.2 x avg.)	(10.0) Cr
Exchange differences			(B - (A - C)	(18.8) Cr
Closing balance (B)		**70.6 Dr**		**70.6 Dr**

Remaining expected future cash flows at the end of Year 1; claims in £ is translated to $ using year-end closing rate:

Using current assumptions at end of Year 1	IFRS 17 amounts are determined in:		Amounts are translated applying IAS 21 into:	
		$		€
Premiums ($)		800.0 Dr		
Claims ($)		(200.0) Cr		
Claims (£)	(450 x (1 ÷ 0.85)	(529.4) Cr		
Closing balance (B)		**70.6 Dr**	**(70.6 x 1)**	**70.6 Dr**

Effect of subsequent changes in exchange rates between £ and US$ (group currency) is recognised as a change in financial risk in **insurance finance income or expenses (IFIE)**

Translation from US$ to € (functional currency) is recognised as IAS 21 exchange difference in **profit or loss (P/L)**

Illustrative Example

Measuring a multi-currency group of insurance contracts (cont'd)

Using single-currency denomination approach (cont'd)

The table below shows the change in the **carrying amount of the CSM** at the end of Year 1:

Items:	IFRS 17 amounts are determined in:		Amounts are translated applying IAS 21 into:	
		$		**€**
Opening balance		–		–
Contracts issued @ Y1		(27.9) Cr		(26.5) Cr
Allocation for services provided	(27.9 ÷ 3 years)	9.3 Dr	(9.3 x avg.)	9.1 Dr
Closing balance (A)		**(18.6) Cr**		**(17.4) Cr**
Exchange differences		0	(A – B)	(1.2) Cr
Closing balance (B)		**(18.6) Cr**	(18.6 x 1)	**(18.6) Cr**

Effect of translation of the group currency from US$ to € is recognised as IAS 21 exchange difference in **P/L**.

Illustrative Example

Measuring a multi-currency group of insurance contracts (cont'd)

Using multi-currency denomination approach

The table shows how the carrying amounts of the fulfilment cash flows and the CSM are calculated at **initial recognition**:

Items:	IFRS 17 amounts are determined in both:		Each currency amount is translated applying IAS 21 into:	
	$	**£**	**€**	
Fulfilment cash flows				
Premiums ($)	1,200.0 Dr		(1,200 x 0.95)	1,140.0 Dr
Claims ($)	(300.0) Cr		(300 x 0.95)	(285.0) Cr
Claims (£)		(750.0) Cr	(750 x 1.11)	(832.5) Cr
	900.0 Dr	(750.0) Cr		**22.5 Dr**
CSM	(900.0) Cr	750.0 Dr	(900 x 0.95) – (750 x 1.11)	**(22.5) Cr**

There is **no single currency** in which the group is denominated.

CSM for each currency portion from the fulfilment cash flows is determined

Illustrative Example

Measuring a multi-currency group of insurance contracts (cont'd)

Using multi-currency denomination approach (cont'd)

The table below shows the change in the **carrying amount of the fulfilment cash flows** at the end of Year 1:

Items:	IFRS 17 amounts are determined in both:		Each currency amount is translated applying IAS 21 into:	
	$	£	€	
Opening balance	–	–		–
Contracts issued @ Y1	900.0 Dr	(750.0) Cr		22.5 Dr
Premiums received ($)	(400.0) Cr		(400 x 0.95)	(380.0) Cr
Claims paid ($)	100.0 Dr		(100 x 1)	100.0 Dr
Claims paid (£)		300.0 Dr	(300 x 1.18)	354.0 Dr
Closing balance (A)	**600.0 Dr**	**(450.0) Cr**		**96.5 Dr**
IFIE (C)				–
Exchange differences			(B – A)	(27.5) Cr
Closing balance (B)	**600.0 Dr**	**(450.0) Cr**		**69.0 Dr**

Remaining expected fulfilment cash flows at the end of Year 1; both amounts in foreign currency are translated to € using year-end closing rate:

Using current assumptions at end of Year 1	IFRS 17 amounts are determined in both:		Each currency amount is translated applying IAS 21 into:	
	$	£	€	
Premiums ($)	800.0 Dr		(800 x 1)	800.0 Dr
Claims ($)	(200.0) Cr		(200 x 1)	(200.0) Cr
Claims (£)		(450.0) Cr	(450 x 1.18)	(531.0) Cr
Closing balance (B)	**600.0 Dr**	**(450.0) Cr**		**69.0 Dr**

All changes in exchange rates are treated as IAS 21 exchange differences in **P/L**.

Illustrative Example

Measuring a multi-currency group of insurance contracts (cont'd)

Using multi-currency denomination approach (cont'd)

The table below shows the change in the **carrying amount of the CSM** at the end of Year 1:

Items:	**IFRS 17 amounts are determined in both:**		**Each currency amount is translated applying IAS 21 into:**	
	$	**£**	**€**	
Opening balance	–	–		–
Contracts issued @ Y1	(900.0) Cr	750.0 Dr		(22.5) Cr
Allocation for services provided	300.0 Dr	(250.0) Cr	(300 x avg.) – (250 x avg.)	6.3 Dr
Closing balance (A)	**(600.0) Cr**	**500.0 Dr**		**(16.2) Cr**
Exchange differences			(A – B)	6.2 Dr
Closing balance (B)	**(600.0) Cr**	**500.0 Dr**	(600 x 1) – (500 x 1.18)	**(10.0) Cr**

All CSM currency portions are translated to € and the effect is recognised as IAS 21 exchange difference in **P/L**.

Illustrative Example

Measuring a multi-currency group of insurance contracts – negative CSM after translation

Same fact pattern from the illustrative example applies **except** the rounded exchange rates for each currency are as follow:

What if the changes in foreign currency exchange rates would cause the CSM to become negative?

	At recognition	End of Year 1	Average
US$1	€0.95	€1.00	€0.98
£1	€1.11	**€1.23**	€1.17

The table shows how the carrying amounts of the fulfilment cash flows and the CSM are calculated at **initial recognition using the multi-currency approach**:

Items:	**IFRS 17 amounts are determined in both:**		**All amounts are translated applying IAS 21 into:**	
	$	**£**	**€**	
Fulfilment cash flows				
Premiums ($)	1,200.0 Dr		(1,200 x 0.95)	1,140.0 Dr
Claims ($)	(300.0) Cr		(300 x 0.95)	(285.0) Cr
Claims (£)		(750.0) Cr	(750 x 1.11)	(832.5) Cr
	900.0 Dr	(750.0) Cr		**22.5 Dr**
CSM	(900.0) Cr	750.0 Dr		**(22.5) Cr**

Illustrative Example

Measuring a multi-currency group of insurance contracts – negative CSM after translation (cont'd)

Using multi-currency denomination approach (cont'd)

The table below shows the change in the **carrying amount of the fulfilment cash flows** at the end of Year 1:

Items:	**IFRS 17 amounts are determined in both:**		**Each currency amount is translated applying IAS 21 into:**	
	$	**£**	**€**	
Opening balance	–	–		–
Contracts issued @ Y1	900.0 Dr	(750.0) Cr		22.5 Dr
Premiums received ($)	(400.0) Cr		(400 x 0.95)	(380.0) Cr
Claims paid ($)	100.0 Dr		(100 x 1)	100.0 Dr
Claims paid (£)		300.0 Dr	(300 x **1.23**)	369.0 Dr
Closing balance (A)	**600.0 Dr**	**(450.0) Cr**		**111.5 Dr**
Exchange differences (Dr)			(B – A)	(65.0) Cr
Closing balance (B)	**600.0 Dr**	**(450.0) Cr**		**46.5 Dr**

Remaining fulfilment cash flows at the end of Year 1; all amounts in foreign currency are translated to € using year-end closing rate:

Using current assumptions at end of Year 1	**IFRS 17 amounts are determined in both:**		**Each currency amount is translated applying IAS 21 into:**	
	$	**£**	**€**	
Premiums ($)	800.0 Dr		(800 x 1)	800.0 Dr
Claims ($)	(200.0) Cr		(200 x 1)	(200.0) Cr
Claims (£)		(450.0) Cr	(450 x 1.23)	(553.5) Cr
Closing balance (B)	**600.0 Dr**	**(450.0) Cr**		**46.5 Dr**

Illustrative Example

Measuring a multi-currency group of insurance contracts – negative CSM after translation (cont'd)

Using multi-currency denomination approach (cont'd)

The table below shows the change in the **carrying amount of the CSM** at the end of Year 1:

Items:	IFRS 17 amounts are determined in both:		Each currency amount is translated applying IAS 21 into:	
	$	£	€	
Opening balance	–	–		–
Contracts issued @ Y1	(900.0) Cr	750.0 Dr		(22.5) Cr
Allocation for services provided	300.0 Dr	(250.0) Cr	(300 x avg.) – (250 x avg.)	1.5 Dr
Closing balance (A)	**(600.0) Cr**	**500.0 Dr**		**(21.0) Cr**
Exchange differences			(A – B)	36.0 Dr
Closing balance (B)	**(600.0) Cr**	**500.0 Dr**	(600 x 1) – (500 x **1.23**)	**15.0 Dr**
Adjustment to CSM				**(15.0) Cr**
Adjusted closing balance	**(600.0) Cr**	**500.0 Dr**		–

*CSM represents the unearned profit of the group and thus, **cannot be negative**.*

The translation to functional currency results in the CSM to be a negative amount, despite no unfavourable changes in the fulfilment cash flows

CSM will be limited to zero by recognising a loss in P/L after booking the gain of 36.0 CU that creates a CSM asset of 15.0 CU.

Cr FX gain		**36.0**
Dr CSM	**36.0**	
Cr CSM		**15.0**
Dr Loss	**15.0**	

The CSM balance of CU 21.0 Cr is reduced to nil

Practical considerations

Some practical considerations when implementing these requirements of IFRS 17:

- Assess the nature and extent of currency exchange rate risks transferred from an insurance contract to the entity and apply judgement in assessing ‘similar risks’ when identifying portfolios of insurance contracts. Accordingly, there is a need to configure the IFRS 17 system to correctly capture currency risks in the identification of a portfolio.
- Consider grouping contracts with future cash flows that the entity expects to respond similarly in amount and timing to changes in key assumptions, e.g. currency risks. For example, grouping of contracts within the portfolio based on the currency denomination could lead to an operationally less complex approach to CSM currency determination and its accounting.
- When commercially neutral, consider revisiting the contractual terms of existing insurance products for which cash flows are in several currencies to mitigate some of the operational complexities resulting from the application of the AD.
- The IFRS 17 solution that an entity may have implemented should be able to correctly capture the effect of the exchange rate differences and to account for them in the right profit or loss line item when applying the single currency denomination approach.

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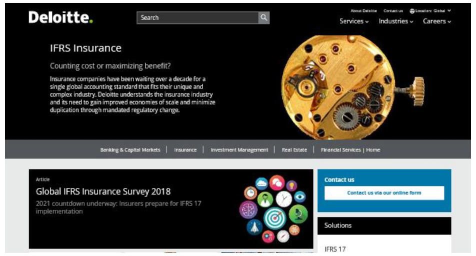

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