

## **Exposure Draft *Amendments to IFRS 17***

**Highlights from the Deloitte comment letter to the International Accounting Standards Board**

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# Agenda

- Key observations in the Deloitte comment letter on the Exposure Draft *Amendments to IFRS 17*
- Highlight of the Deloitte's positions set out in the comment letter
- Next steps

## Key observations in the Deloitte comment letter on the ED amending IFRS 17

- We are generally supportive of the proposals in the Exposure Draft (ED) and have recommended a number of areas where these proposals could be improved.
- The proposal to define **investment–return services** in insurance contracts without direct participation using the approach in the ED appears rule-based. We propose **a principle-based approach that uses exiting concepts in IFRS 17**.
- We believe that the scope of the proposed amendment to account for reinsurance contracts held ('recovery of losses on underlying insurance contracts') **should be extended to all types of reinsurance contracts held**.
- As for the application of the **risk mitigation option** to reinsurance contracts held, we think a better solution could be achieved by **extending the scope of the variable fee approach to include reinsurance contracts held**.
- We note that there is extensive discussion on the accounting for **contracts with "mutualisation" features**. The guidance in IFRS 17 on the accounting for the adjustments to CSM from the changes in fulfilment cash flows arising from these contracts could be improved.

# Contractual service margin attributable to investment-return service and investment-related service

Exposure Draft – Amendments to IFRS 17 [paragraphs 44–45, 109 and 117(c)(v), Appendix A, paragraphs B119–B119B and BC50–BC66]

## Deloitte Comment Letter

### Our position

*"We **support** the IASB proposal to address the lack of guidance on how to determine the coverage units that are related to investment services."*

### Our concern

*"The Transition Resource Group's discussions on coverage units have revealed that several insurers struggle with the implementation of the CSM allocation requirements in IFRS 17, and the amendment would address some of the concerns raised."*

### Scope of amendment and Deloitte proposal

*"(...) to promote consistent application of the proposed amendment, we recommend that the IASB defines the term '**investment-return services**' using a **principle-based approach**."*

*"Our proposal is to define the scope of such contracts using an already existing principle expressed in IFRS 17:B75."*

# Reinsurance contracts held—recovery of losses on underlying insurance contracts

## Exposure Draft – Amendments to IFRS 17 [paragraphs 62, 66A–66B, B119C–B119F and BC67–BC90]

Paragraph 66A proposes that an entity **adjust the contractual service margin** of a group of reinsurance contracts held that provides proportionate coverage, and as a result recognise income, when the entity recognises a loss on initial recognition of an onerous group of underlying insurance contracts, or on addition of onerous contracts to that group. (...)

## Deloitte Comment Letter

### Our position

*"We are **supportive** of the IASB's proposal to reflect the benefit of coverage provided by reinsurance contracts to cedants, however, we do not think that the proposed amendment goes far enough."*

### Our concern

*"Our main concerns are with regard to the scope of the amendment and the subsequent measurement of reinsurance contracts held when applying the amended paragraphs."*

### Scope of amendment

*"With regard to the scope, we note that the term '**proportionate coverage**' is defined in IFRS 17:B119C of the ED as 'the right to recover from the issuer [of the reinsurance contract] a fixed percentage of all claims incurred on a group of underlying insurance contracts.'"*

## Reinsurance contracts held—recovery of losses on underlying insurance contracts

### Deloitte proposal

*"We believe that the existing principle in IFRS 17:66(c)(ii) should be extended to **initial recognition** and this approach would provide a sound basis for calculating day one gain on reinsurance contracts held when and only to the extent that they mitigate the onerous loss on a group of reinsured insurance contracts issued."*

*"Additionally, in relation to the current IFRS 17:63 requirement for subsequent measurement of reinsurance contracts held, we would like to point out that the **initial locked-in discount rate** applicable to a group of reinsurance contracts held would not correspond to the time when the underlying insurance contracts are issued and reinsured."*

*"Yet, at initial recognition of the reinsurance contract held, the **time value of money** for contracts yet to be issued is unknown and the CSM for the stand-ready obligation associated with those future contracts is not allocated to profit or loss."*

*"(...) we propose requiring the CSM related to expected future issuances to be measured using **yield curves of future interest rates** applicable to those cash flows and discounting them at the current rate applicable at the balance sheet date."*

# Applicability of the risk mitigation option

## Exposure Draft – Amendments to IFRS 17 [paragraphs B116 and BC101–BC109]

The proposed amendment to paragraph B116 would extend the **risk mitigation option** available when an entity uses derivatives to mitigate financial risk arising from insurance contracts with direct participation features. That option would apply in circumstances when an entity uses reinsurance contracts held to mitigate financial risk arising from insurance contracts with direct participation features.

## Deloitte Comment Letter

### Our position

*"Whilst **we do not disagree** with the IASB's proposal in trying to address stakeholder concerns with regard to potential accounting mismatches created by the variable fee approach (VFA), we think a better solution is possible."*

### Our concern

*"We believe that **extending the eligibility for the VFA** to reinsurance contracts held would eliminate any accounting mismatch more effectively than the proposed solution to extend the scope of the **risk mitigation option** to reinsurance contracts held."*

# Applicability of the risk mitigation option

## Scope of amendment

*"Extending the scope of VFA to reinsurance contracts would result in **the application of consistent principles and criteria** to all insurance contracts and **would remove any optionality**."*

## Deloitte proposal

*"(...) we propose an amendment to the proposed IFRS 17:B115 to say*

*"to the extent the entity meets the conditions in paragraph B116 and to the extent that the change in the contractual service margin is economically offset by any reinsurance contract held for the purposes described in paragraph B116, it may choose not to recognise a such change in the contractual service margin to reflect changes in the effect of financial risk on the amount of the entity's share of the underlying items or the fulfilment cash flows set out in paragraph B113(b)."*

# 'Mutualisation' contracts

## Deloitte Comment Letter

### Appendix 2 Accounting for the CSM and changes in fulfilment cash flows for contracts described in IFRS 17:B67

*"A material proportion of issued insurance contracts within the scope IFRS 17 have cash flows that affect or are affected by cash flows of other insurance contracts and therefore are subject to **the guidance in IFRS 17:B67-B71** to account for fulfilment cash flows and CSM."*

*"As noted in IFRS 17:BC171, these contracts have been commonly referred to as having **'mutualisation'** characteristics."*

### Our Concern

*"We have observed that **the existing guidance in IFRS 17 does not result in a consistent accounting treatment** when the entity adjusts the CSM for the changes in fulfilment cash flows that relate to future services."*

### Deloitte proposal

*"The IASB could **amend IFRS 17 to clarify** that the entity adjusts the CSM **at a level of a single combined risk-sharing portfolio**. IFRS 17 could be clear that all groups will have their CSM amounts adjusted in proportion to the changes determined at the same level of aggregation as the conditions described in IFRS 17:B67-68 would have determined to be."*

## 'Mutualisation' contracts

### Example - Fully mutualised portfolio, pro-rata sharing of risks, fixed % of equity holder participation

"Entity A has issued contracts to **10 groups of policyholders**, all forming a **single portfolio**, paying a premium of CU 1,000 each and each sharing equally in the returns of the insurance contracts portfolio. The portfolio of insurance contracts is a specified pool of underlying items. **The returns of this pool are derived from the performance of insurance contracts** (premiums, claims and other insurance contracts' cash flows)."

	A Group 1 CU	B Each of groups 2-10 CU	C = B x 9 Total of groups 2-10 CU	D= A+ C Total of 10 groups CU
Premium	1,000	1,000	9,000	10,000
Claim	(4,000)	0	0	(4,000)
	(3,000)	1,000	9,000	6,000
90% Profit share	(540)	(540)	(4,860)	(5,400)
Subsidy	3,600	(400)	(3,600)	-
CSM	60	60	540	600

"We believe that applying IFRS 17:B68 makes it possible to **interpret 'payments arising from terms of existing contracts to policyholders of other groups [...]'** to include a group's share in the 100% of the losses and 100% of the premiums before attributing to the group its share of a fixed percentage (i.e. less than 100%, 90% in the illustrative example above) of the net portfolio result and that the correct application of paragraph B112 is to include in the variable fee the entity's share of the amounts that are **"mutualised"** across the groups of the portfolio."

# Expected recovery of insurance acquisition cash flows

Exposure Draft – *Amendments to IFRS 17 [paragraphs 28A–28D, 105A–105C, B35A–B35C and BC31–BC49]*

## Deloitte Comment Letter

### Our position

*"We **support** the proposals in the ED that entities should allocate insurance acquisition cash flows to expected renewals of contracts. (...)*

*"We **agree** with the IASB that the proposed accounting treatment would provide useful information to users of financial statements about acquisition cash flows."*

### Our concern

*"We note that the impairment test for the insurance acquisition cash flows asset described in the proposed IFRS 17:B35B does not explicitly address whether it is necessary to take into account the **time value of money**."*

*"Further, we note that the current words in IFRS 17:59(a) and in the proposed IFRS 17:28A allow expensing of insurance acquisition cash flows for entities applying the premium allocation approach when the groups of contracts have a coverage **not exceeding one year**."*

## Expected recovery of insurance acquisition cash flows

### Deloitte proposal

*"We believe that more precise guidance on the effect of the time value of money in the impairment test is important."*

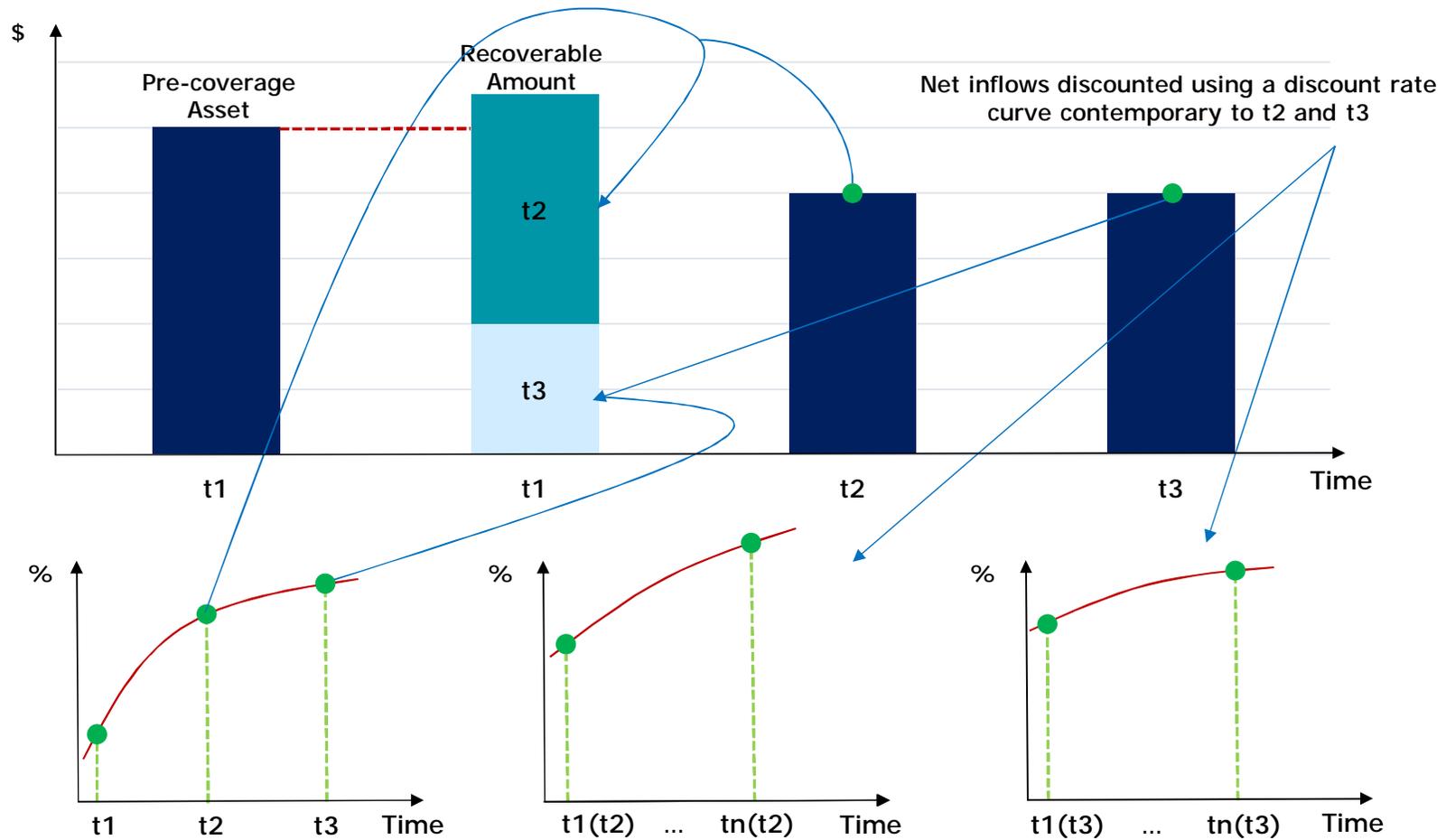
*A diagram in the next page explains our proposal*

*"We **recommend** amending the text of the proposed IFRS 17:28A to say*

*'An entity applying the premium allocation approach may recognise insurance acquisition cash flows as expenses applying paragraph 59(a) only when they are allocated to the group of insurance contracts in accordance with paragraph 28C.'*

*We recommend reflecting a similar change in IFRS 17:59(a)."*

# Expected recovery of insurance acquisition cash flows



Discount rate curve for the portfolio with contracts that will renew and generate the "net cash inflow".

## Scope exclusions—credit card contracts and loan contracts that meet the definition of an insurance contract

Exposure Draft – *Amendments to IFRS 17 [paragraphs 7(h), 8A, Appendix D and BC9–BC30]*

- (a) Paragraph 7(h) proposes that an entity would be required to **exclude from the scope of IFRS 17 credit card contracts** that meet the definition of an insurance contract if, and only if, the entity **does not reflect an assessment of the insurance risk** (...)
- (b) If not excluded from the scope of IFRS 17 by paragraphs 7(a)–(h), paragraph 8A proposes that an entity would **choose to apply IFRS 17 or IFRS 9 to contracts that meet the definition of an insurance contract** (...)

### Deloitte Comment Letter

#### Our position

*"We broadly **support** both of the proposed exclusions from the scope of IFRS 17."*

#### Loan contracts that transfer significant insurance risk

*"We are **supportive** of these proposed amendments because, without the amendments, financial institutions issuing loan contracts that transfer significant insurance risk would have to account for those contracts applying IFRS 17 in their entirety."*

## Scope exclusions—credit card contracts and loan contracts that meet the definition of an insurance contract

### Credit card contracts that provide insurance coverage

"We **support** the proposal in the ED that credit card contracts that provide insurance coverage would be excluded from the scope of IFRS 17 for the reasons noted in the ED."

"We **agree** with paragraph BC14 of the ED that IFRS 9 measurement can address both **credit** and **insurance risks**."

"(...) we believe that IFRS 15 would apply to other elements such as obligations to deliver goods and non-insurance services bundled in some credit cards."

"We also note that the term '**credit card**' is not defined. We believe credit cards are the most common example, rather than the only arrangement for which the scope exclusion should apply to."

## Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4

**Exposure Draft – Amendments to IFRS 17 [Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4 [paragraphs C1, [Draft] Amendments to IFRS 4 and BC110–BC118]**

- (a) The proposed amendment to paragraph C1 would defer the effective date of IFRS 17 by one year from annual reporting periods beginning on or after 1 January 2021 to annual reporting periods beginning **on or after 1 January 2022**.
- (a) The proposed amendment to paragraph 20A of IFRS 4 would extend the temporary exemption from IFRS 9 by one year so that an entity applying the exemption would be required to **apply IFRS 9 for annual reporting periods beginning on or after 1 January 2022**.

### Deloitte Comment Letter

*"We **agree** with the deferral of both IFRS 17 effective date and the delayed application of IFRS 9 for entities with significant insurance operations. We note that it will likely remain a challenging deadline for many preparers."*

## Presentation in the statement of financial position

### Exposure Draft – *Amendments to IFRS 17 [paragraphs 78–79, 99, 132 and BC91–BC100]*

The proposed amendment to paragraph 78 would require an entity to present separately in the statement of financial position **the carrying amount of portfolios of insurance contracts issued that are assets and those that are liabilities**. Applying the existing requirements, an entity would present the carrying amount of groups of insurance contracts issued that are assets and those that are liabilities. The amendment would also apply to portfolios of reinsurance contracts held that are assets and those that are liabilities.

### Deloitte Comment Letter

*"We **support** this proposed amendment mainly for the reasons stated in the Basis for Conclusions to the ED."*

## Transition modifications and reliefs

Exposure Draft – *Amendments to IFRS 17 [paragraphs C3(b), C5A, C9A, C22A and BC119–BC146]*

- (a) Paragraph C9A proposes an **additional modification in the modified retrospective approach** (...)
- (b) The proposed amendment to paragraph C3(b) would **permit an entity to apply the option in paragraph B115 prospectively from the transition date, rather than the date of initial application.** (...)
- (c) Paragraph C5A proposes that an entity that can apply IFRS 17 retrospectively to a group of direct participating insurance contracts be **permitted to instead apply the fair value approach to that group when they are part of a risk mitigation relationship from transition date.** (...)

### Deloitte Comment Letter

#### *Classification of contracts acquired in their settlement period*

"We **support** the proposal in the ED, however we note that this exemption is applicable only on transition and only to the extent the entity does not have reasonable and supportable information for the full retrospective approach."

#### *Risk mitigation for insurance contracts with direct participation features*

"We are **supportive** of the IASB's proposals for the reasons stated in the Basis for Conclusions to the ED."

## Transition modifications and reliefs

### *Risk mitigation for insurance contracts with direct participation features and the use of the fair value transition approach*

*"We **agree** with the IASB's proposed amendment. We support it as an innovative way of resolving to a significant extent the accounting mismatch issue that otherwise would have most likely persisted for a number of years after transition."*

## Minor amendments

### Exposure Draft – *Amendments to IFRS 17 [BC147–BC163]*

This Exposure Draft also proposes minor amendments (see paragraphs BC147–BC163 of the Basis for Conclusions).

### Deloitte Comment Letter

#### *Our position*

*"We are **supportive** of most of the minor amendments proposed in the Exposure Draft. In some cases, we have proposed an alternative approach that we believe achieves what the IASB had intended, is a fair reflection of the underlying economic substance and is aligned with the principles of IFRS 17."*

#### *Excluding changes from cash flows relating to loans to policyholders from revenue*

*"Defining **investment components** by using a symmetrical concept of the cash flows involved (i.e. acknowledging that the investment component can be an asset or a liability) would avoid (...) the need to amend paragraph B123(a)."*

#### *Definition of an investment component*

*"(...) we **propose** to define investment components as cash flows that are 100% certain of repayment and for which repayment is contingent only on the passage of time."*

## Minor amendments

### Excluding changes relating to the time value of money and assumptions that relate to financial risk from changes in the carrying amount of the contractual service margin

"we **propose** that entities should be required to exclude from the CSM all differences between investment components expected to become payable and actual payments and reflect them in the insurance finance income or expense. To achieve this outcome, we propose to delete IFRS 17:B96(c)."

### Changes in the risk adjustment for non-financial risks

"(...) we **propose** to leave the existing text of IFRS 17:B96(d) and to clarify that the change in the risk adjustment relating to future service always adjusts the CSM at the current rate."

### Recognition of contracts within a group

"We **propose** to amend IFRS 17:22 in the same way, consistent with the amendment to IFRS 17:28."

## Next steps

- The IASB will consider comments received on the Exposure Draft before 25 September 2019 and will decide whether to proceed with the proposed amendments to IFRS 17.
- The IASB plans to publish the amended IFRS 17 in **mid-2020**.

## Contact details

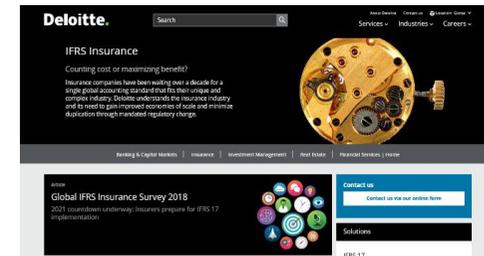
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