IFRS 17 issues – Transition
Amended draft for discussion

1 Current IASB requirements and TRG conclusions

1.1 IFRS 17 requirements

1 IFRS 17.88: Unless paragraph 89 applies, an entity shall make an accounting policy choice between:

(a) including insurance finance income or expenses for the period in profit or loss; or

(b) disaggregating insurance finance income or expenses for the period to include in profit or loss an amount determined by a systematic allocation of the expected total insurance finance income or expenses over the duration of the group of contracts, applying paragraphs B130–B133.

2 IFRS 17.89: For insurance contracts with direct participation features, for which the entity holds the underlying items, an entity shall make an accounting policy choice between:

(a) including insurance finance income or expenses for the period in profit or loss; or

(b) disaggregating insurance finance income or expenses for the period to include in profit or loss an amount that eliminates accounting mismatches with income or expenses included in profit or loss on the underlying items held, applying paragraphs B134-B136.

3 IFRS 17.90: If an entity chooses the accounting policy set out in paragraph 88(b) or in paragraph 89(b), it shall include in other comprehensive income the difference between the insurance finance income or expenses measured on the basis set out in those paragraphs and the total insurance finance income or expenses for the period.

4 IFRS 17.91: If an entity transfers a group of insurance contracts or derecognises an insurance contract applying paragraph 77:

(a) it shall reclassify to profit or loss as a reclassification adjustment (see IAS 1 Presentation of Financial Statements) any remaining amounts for the group (or contract) that were previously recognised in other comprehensive income because the entity chose the accounting policy set out in paragraph 88(b).

(b) it shall not reclassify to profit or loss as a reclassification adjustment (see IAS 1) any remaining amounts for the group (or contract) that were previously recognised in other comprehensive income because the entity chose the accounting policy set out in paragraph 89(b).

5 IFRS 17.116: An entity that chooses to disaggregate insurance finance income or expenses between profit or loss and other comprehensive income applies paragraphs C18(b), C19(b), C24(b) and C24(c) to determine the cumulative difference between the insurance finance income or expenses that would have been recognised in profit or loss and the total insurance finance income or expenses at the transition date for the groups of insurance contracts to

which the disaggregation applies. For all periods in which amounts determined applying these paragraphs exist, the entity shall disclose a reconciliation from the opening to the closing balance of the cumulative amounts included in other comprehensive income for financial assets measured at fair value through other comprehensive income related to the groups of insurance contracts. The reconciliation shall include, for example, gains or losses recognised in other comprehensive income in the period and gains or losses previously recognised in other comprehensive income in previous periods reclassified in the period to profit or loss.

6 IFRS 17.B93: When an entity acquires insurance contracts issued or reinsurance contracts held in a transfer of insurance contracts that do not form a business or in a business combination, the entity shall apply paragraphs 14–24 to identify the groups of contracts acquired, as if it had entered into the contracts on the date of the transaction.

7 IFRS 17.B101: Insurance contracts with direct participation features are insurance contracts that are substantially investment-related service contracts under which an entity promises an investment return based on underlying items. Hence, they are defined as insurance contracts for which:

(a) the contractual terms specify that the policyholder participates in a share of a clearly identified pool of underlying items (see paragraphs B105–B106);

(b) the entity expects to pay to the policyholder an amount equal to a substantial share of the fair value returns on the underlying items (see paragraph B107); and

(c) the entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items (see paragraph B107).

8 IFRS 17.B115: To the extent that an entity meets the conditions in paragraph B116, it may choose not to recognise a change in the contractual service margin to reflect some or all of the changes in the effect of financial risk on the entity's share of the underlying items (see paragraph B112) or the fulfilment cash flows set out in paragraph B113(b).

9 IFRS 17.B116: To apply paragraph B115, an entity must have a previously documented risk-management objective and strategy for using derivatives to mitigate financial risk arising from the insurance contracts and, in applying that objective and strategy:

(a) the entity uses a derivative to mitigate the financial risk arising from the insurance contracts.

(b) an economic offset exists between the insurance contracts and the derivative, ie the values of the insurance contracts and the derivative generally move in opposite directions because they respond in a similar way to the changes in the risk being mitigated. An entity shall not consider accounting measurement differences in assessing the economic offset.

(c) credit risk does not dominate the economic offset.

10 IFRS 17.B132: For groups of insurance contracts for which changes in assumptions that relate to financial risk have a substantial effect on the amounts paid to the policyholders:

(a) a systematic allocation for the finance income or expenses arising from the estimates of future cash flows can be determined in one of the following ways:

(i) using a rate that allocates the remaining revised expected finance income or expenses over the remaining duration of the group of contracts at a constant rate; or

(ii) for contracts that use a crediting rate to determine amounts due to the policyholders—using an allocation that is based on the amounts credited in the period and expected to be credited in future periods.

(b) a systematic allocation for the finance income or expenses arising from the risk adjustment for non-financial risk, if separately disaggregated from other changes in the risk adjustment for non-financial risk applying paragraph 81, is determined using an allocation consistent with that used for the allocation for the finance income or expenses arising from the future cash flows.

(c) a systematic allocation for the finance income or expenses arising from the contractual service margin is determined:

(i) for insurance contracts that do not have direct participation features, using the discount rates specified in paragraph B72(b); and

(ii) for insurance contracts with direct participation features, using an allocation consistent with that used for the allocation for the finance income or expenses arising from the future cash flows.

11 IFRS 17.B134: Paragraph 89 applies if an entity, either by choice or because it is required to, holds the underlying items for insurance contracts with direct participation features. If an entity chooses to disaggregate insurance finance income or expenses applying paragraph 89(b), it shall include in profit or loss expenses or income that exactly match the income or expenses included in profit or loss for the underlying items, resulting in the net of the two separately presented items being nil.

12 IFRS 17.C3: An entity shall apply IFRS 17 retrospectively unless impracticable, except that:

(a) an entity is not required to present the quantitative information required by paragraph 28(f) of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors; and

(b) an entity shall not apply the option in paragraph B115 for periods before the date of initial application of IFRS 17.

13 IFRS 17.C5: If, and only if, it is impracticable for an entity to apply paragraph C3 for a group of insurance contracts, an entity shall apply the following approaches instead of applying paragraph C4(a):

(a) the modified retrospective approach in paragraphs C6–C19, subject to paragraph C6(a); or

(b) the fair value approach in paragraphs C20–C24.

14 IFRS 17.C6: The objective of the modified retrospective approach is to achieve the closest outcome to retrospective application possible using reasonable and supportable information available without undue cost or effort. Accordingly, in applying this approach, an entity shall:

(a) use reasonable and supportable information. If the entity cannot obtain reasonable and supportable information necessary to apply the modified retrospective approach, it shall apply the fair value approach.

(b) maximise the use of information that would have been used to apply a fully retrospective approach, but need only use information available without undue cost or effort.

15 IFRS 17.C7: Paragraphs C9–C19 set out permitted modifications to retrospective application in the following areas:

(a) assessments of insurance contracts or groups of insurance contracts that would have been made at the date of inception or initial recognition;

(b) amounts related to the contractual service margin or loss component for insurance contracts without direct participation features;

(c) amounts related to the contractual service margin or loss component for insurance contracts with direct participation features; and

(d) insurance finance income or expenses.

16 IFRS 17.C8: To achieve the objective of the modified retrospective approach, an entity is permitted to use each modification in paragraphs C9–C19 only to the extent that an entity does not have reasonable and supportable information to apply a retrospective approach

17 IFSR 17.C10: To the extent permitted by paragraph C8, an entity shall not apply paragraph 22 to divide groups into those that do not include contracts issued more than one year apart.

18 IFRS 17.C19: For groups of insurance contracts that do not include contracts issued more than one year apart:

(a) if an entity applies paragraph C13 to estimate the discount rates that applied at initial recognition (or subsequently), it shall also determine the discount rates specified in paragraphs B72(b)–B72(e) applying paragraph C13; and

(b) if an entity chooses to disaggregate insurance finance income or expenses between amounts included in profit or loss and amounts included in other comprehensive income, applying paragraphs 88(b) or 89(b), the entity needs to determine the cumulative amount of insurance finance income or expenses recognised in other comprehensive income at the transition date to apply paragraph 91(a) in future periods. The entity shall determine that cumulative difference:

(i) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B131—if the entity applies paragraph C13 to estimate the discount rates at initial recognition—using the discount rates that applied at the date of initial recognition, also applying paragraph C13;

(ii) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B132—on the basis that the assumptions that relate to financial risk that applied at the date of initial recognition are those that apply on the transition date, ie as nil;

(iii) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B133—if the entity applies paragraph C13 to estimate the discount rates at initial recognition (or subsequently)—using the discount rates that applied at the date of the incurred claim, also applying paragraph C13; and

(iv) for insurance contracts with direct participation features to which paragraph B134 applies—as equal to the cumulative amount recognised in other comprehensive income on the underlying items.

19 IFRS 17.C20: To apply the fair value approach, an entity shall determine the contractual service margin or loss component of the liability for remaining coverage at the transition date as the difference between the fair value of a group of insurance contracts at that date and the fulfilment cash flows measured at that date. In determining that fair value, an entity shall not apply paragraph 47 of IFRS 13 Fair Value Measurement (relating to demand features).

20 IFRS 17.C25: Notwithstanding the reference to the annual reporting period immediately preceding the date of initial application in paragraph C2(b), an entity may also present adjusted comparative information applying IFRS 17 for any earlier periods presented, but is not required to do so. If an entity does present adjusted comparative information for any earlier periods, the reference to 'the beginning of the annual reporting period immediately preceding the date of initial application' in paragraph C2(b) shall be read as 'the beginning of the earliest adjusted comparative period presented'.

21 IFRS 17. C31: An entity that applies paragraph C29 is not required to restate prior periods to reflect such changes in designations or classifications. The entity may restate prior periods only if it is possible without the use of hindsight. If an entity restates prior periods, the restated financial statements must reflect all the requirements of IFRS 9 for those affected financial assets. If an entity does not restate prior periods, the entity shall recognise, in the opening retained earnings (or other component of equity, as appropriate) at the date of initial application, any difference between:

(a) the previous carrying amount of those financial assets; and

(b) the carrying amount of those financial assets at the date of initial application.

22 IFRS 17.BC388: The Board concluded that providing restated comparative information for at least one reporting period was necessary because of the diversity of previous accounting and the extent of the changes introduced by IFRS 17. Because IFRS 17 only

requires retrospective application on transition if practicable, and specifies simplified approaches when retrospective application is impracticable, the Board expects that determining the comparative amounts will not require significant incremental time and resources beyond those required to first apply IFRS 17. The Board set the effective date for IFRS 17 based on information given about the necessary time to prepare, in the knowledge that restated comparative information for one reporting period would be required.

23 IFRS 17.BC389: The requirement to restate comparative information for one reporting period is different from the transition requirements of IFRS 9, which did not require restatement of comparative amounts at transition to that Standard, including the fair value of financial instruments (and which did not allow restatement if doing so required the use of hindsight). However, the Board noted that different circumstances applied when it developed the transition requirements for IFRS 9, which were developed with the intention of minimising obstacles to voluntary application of IFRS 9 before its effective date. In addition, entities applying those transition requirements of IFRS 9 had all previously applied the same requirements, ie those in IAS 39. In contrast, the Board expects that most entities will apply IFRS 17 no earlier than the effective date and believes that the restatement of comparative amounts is particularly important, for the reasons given in paragraph BC388. Therefore, the Board decided not to provide relief from the restatement of comparative information to facilitate early application of IFRS 17.

24 IFRS 17.BC393: Paragraph B115 of IFRS 17 permits entities not to recognise a change in the contractual service margin for changes in fulfilment cash flows and the entity’s share in the fair value returns on underlying items for which an entity uses derivatives to mitigate their financial risk. However, an entity applying this option is required to document its risk management objective and the strategy for mitigating the risk before doing so. This documentation requirement is analogous to the documentation requirements for hedge accounting in IFRS 9. Consistent with the transition requirements for hedge accounting in IFRS 9, the Board concluded that retrospective application of the risk mitigation treatment would give rise to the risk of hindsight. In particular, the Board was concerned that documentation after the event could enable entities to choose the risk mitigation relationships to which it would apply this option, particularly because the application of this approach is optional. Consequently, IFRS 17, consistent with the transition requirements for hedge accounting in IFRS 9, requires prospective application of the risk mitigation option from the date of initial application of the Standard.

25 IFRS 9.7.2.1: An entity shall apply this Standard retrospectively, in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, except as specified in paragraphs 7.2.4–7.2.26 and 7.2.28. This Standard shall not be applied to items that have already been derecognised at the date of initial application.

1.2 Tentative Board's decisions

<u>February 2019 meeting</u>

26 IASB 2019-02 AP 2C §13: The staff think that applying the risk mitigation option retrospectively without using hindsight is challenging. The entity would have to determine what amounts it would have recognised in profit or loss for the mitigated risks. The staff also think that retrospectively applying an option that is prospective by nature gives rise to 'cherry picking' opportunities. Retrospective application of the risk mitigation option could also lead to unjustified inconsistency with the requirements for hedge accounting in IFRS 9 that prohibits the retrospective application of hedge accounting for the same reason.

27 IASB 2019-02 AP 2C §14: To illustrate, if the Board were to permit the risk mitigation option to be applied retrospectively, entities that have a previously documented risk-management objective and strategy for using derivatives to mitigate financial risk arising from the insurance contracts could, for example:

(a) choose retrospectively the risk mitigation relationships to which they apply the option based on the outcome known at the effective date;

(b) determine the fulfilment cash flows in a group to which the risk mitigation option applies retrospectively based on the outcome known at the effective date; and

(c) determine when to start applying the risk mitigation option based on the outcome known at the effective date, even if the derivative had the same risk mitigating effect in previous periods.

28 IASB 2019-02 AP 2C §20: When an entity chooses to disaggregate insurance finance income or expenses between profit or loss and OCI, it may be permitted or required to determine the cumulative amount of insurance finance income or expenses recognised in OCI at the transition date as nil in the following circumstances:4

(a) permitted when applying the fair value approach (paragraph C24(b) of IFRS 17);

(b) permitted when applying the modified retrospective approach for groups of insurance contracts that include contracts issued more than one year apart (paragraph C18(b) of IFRS 17); and

(c) required when applying the modified retrospective approach for groups of insurance contracts that do not include contracts issued more than one year apart for insurance contracts for which changes in assumptions that relate to financial risk have a substantial effect on the amounts paid to the policyholders (paragraph C19(b)(ii) of IFRS 17).

29 IASB 2019-02 AP 2C §27: Some stakeholders have suggested the Board should amend the requirements of IFRS 17 or IFRS 9 to either:

(a) permit an entity to deem the accumulated amount of finance income in OCI related to related assets as nil at transition to IFRS 17; or

(b) permit an entity to deem the accumulated amount of insurance finance income or expenses in OCI for these insurance contracts at the same amount as the accumulated amount of finance income in OCI on the related assets at transition.

30 IASB 2019-02 AP 2D §18: The staff observe that, generally, an entity would be expected to use information that is reasonable and supportable in the preparation of financial statements to meet the objective of providing useful information to users of financial statements.

31 IASB 2019-02 AP 2D §36: The staff think that in the light of stakeholder feedback in paragraph 30 of this paper, if the Board decides not to permit entities to develop their own unspecified modifications, it may be helpful to stakeholders if the Board were to explain in the Basis for Conclusions on IFRS 17 that the existence of specified modifications in the modified retrospective approach does not prohibit an entity from:

(a) making estimates that are necessary in retrospectively applying an accounting policy as described in paragraph 51 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors; or

(b) similarly, making estimates when applying a specified modification in the modified retrospective approach.

<u>March 2019 meeting</u>

32 IASB 2019-03 AP 2E §16: The staff considered two possible ways, other than retrospective application of the risk mitigation option, to address stakeholders' concerns:

(a) permitting entities to apply a prospective application of the risk mitigation option from the IFRS 17 transition date; and

(b) permitting entities that have used derivatives or reinsurance contracts held to mitigate financial risk arising from insurance contracts with direct participating features before the transition date to apply the fair value approach to transition, even if they are able to apply IFRS 17 retrospectively.

<u>April 2019 meeting</u>

33 IASB 2019-04 AP 2C §34: The staff observe that proposing any changes to IFRS 9, particularly with respect to the transition requirements, may risk unintended consequences. Given that insurers can mitigate some of these concerns by applying IFRS 9 for the first time before they apply IFRS 17 for the first time, the staff think that a change to the requirements of IFRS 9 is not required.

1.3 Current understanding of the accounting treatment

<u>Selection of a transition methodology</u>

34 On transition, IFRS 17.C3 requires to apply the full retrospective approach (FRA) unless impracticable. In the latter case, the entity may apply either the fair value approach (FVA) or the modified retrospective approach (MRA).

35 No specific provision is given relating to the FRA. By contrast, the MRA is providing some relief absent reasonable and supportable information to apply the FRA (IFRS 17.C06-IFRS 17.C19). Guidance is also provided on how to apply the FVA (IFRS 17.C20-IFRS 17.C24).

36 Considering that the FVA can only be applied upon the date of transition (IFRS 17.C20) and not in prior periods, a chosen approach appears to apply to the entirety of a given group of insurance contracts, e.g. mixed approaches would not be possible.

37 When considering the issue at its February meeting, IASB considered that using information that is reasonable and supportable in the preparation of the FS would meet the objectives set in a retrospective approach. The Board noted the importance of the clarification in the paper that the existence of specified modifications does not preclude the normal use of estimation techniques.

<u>OCI option</u>

38 As summarised by the staff in an agenda paper to the board (IASB 2019-02 AP 2C §20), when an entity chooses to disaggregate insurance finance income or expenses between profit or loss and OCI (IFRS 17.88(b)) in non-VFA contracts, it may be permitted or required to determine the cumulative amount of insurance finance income or expenses recognised in OCI at the transition date as nil in the following circumstances:

- (a) permitted when applying the FVA (IFRS 17.C24(b));
- (b) permitted when applying the MRA for groups of insurance contracts that include contracts issued more than one year apart (IFRS 17.C18(b)); and
- (c) required when applying the MRA for groups of insurance contracts that do not include contracts issued more than one year apart for insurance contracts for which changes in assumptions that relate to financial risk have a substantial effect on the amounts paid to the policyholders (IFRS 17.C19(b)(ii)).

39 In its February meeting, the board considered and discarded two scenarios:

- to amend IFRS 9 in order to also set to zero the OCI on assets;
- to deem the accumulated amount of OCI on assets at the same amount as on insurance contracts. This solution is exposed to subjectivity in allocating the assets to liabilities as well as setting the discount rate on transition.

<u>Interaction with IFRS 9 – Risk mitigation</u>

40 IFRS 17.C3(b) specifically prohibits a retrospective application of the risk mitigation option for direct participating contracts.

41 IFRS 17.BC 393 justifies that "consistent with the transition requirements for hedge accounting in IFRS 9, the Board concluded that retrospective application of the risk mitigation treatment would give rise to the risk of hindsight. In particular, the Board was concerned that documentation after the event could enable entities to choose the risk mitigation relationships to which it would apply this option, particularly because the application of this approach is optional".

42 In its analysis during the February 2019 meeting, the board confirmed the view that the risk of "cherry picking" was not acceptable.

43 In its March 2019 meeting, the board decided permitting entities to apply a prospective application of the risk mitigation option (to derivatives or reinsurance contracts held) from the IFRS 17 transition date.

Interaction with IFRS 9 – Comparative information in 2021

44 Insurers applying the IFRS 4 amendment may defer the IFRS 9 implementation until 1 January 2022.

45 On the first time application of IFRS 17 comparative year 2021 has to be restated (IFRS 17.C25, .BC388 and .BC389) except if IFRS 9 already applied (overlay approach) beforehand so that it may change its previous classification of (“redesignate”) financial instruments without restating prior periods (IFRS 17.C31).

46 By contrast, on the first time application of IFRS 9 comparative year 2021 has not to be restated (IFRS 17.BC 389).

47 If an entity however decides to restate the comparative year 2021:

- financial items that have not been derecognised at the date of initial application would have to be accounted for according to IFRS 9 (IFRS 9.7.2.1);
- financial items that have been derecognised at the date of initial application would need to continue to follow IAS 39 until the date of sale.

48 IASB has addressed the issue raised by ANC in the sweep issues considered at the April’s board meeting. The staff analysed that the issue had already been considered when developing the transition requirements in IFRS 9 and IFRS 17 and that changes to IFRS 9 in that regard may risk unintended consequences. It suggested an earlier FTA of IFRS 9 in order to mitigate such effect.

2 Issue

49 The EFRAG case study has been the unique opportunity at this stage to test on a large basis the practicability of the transition requirements.

50 It raised issues of different natures:

- Operational difficulties in complying with the criteria for applying the three methodologies offered and in gathering data;
- Possible accounting mismatches created by certain requirements.

2.1 Operational difficulties

Selection of a transition methodology

51 Case studies report that the proposed transition methodologies better fit to certain situation. Accordingly:

	The methodology is expected to apply to group of contracts:
FRA	– where data are available (i.e. from 2018 on); – for which reasonable proxies can be made for the missing data based on European embedded value (EEV) or Solvency II information.
MRA	– where no data is available or out of scope of EEV or solvency II
FVA	– data required to perform MRA is not available; – expected CSM at transition is nil or negative: undue complexity of applying a retrospective approach since the recognised insurance contracts on transition only correspond to fulfilment cash-flows; – PAA, since no CSM assessment required on transition

52 Mixed transition approaches appear not applicable. However, for long term contracts a mix transition approach such as an initial FVA and a MRA from this date onward,

would make the calculation of key data (CSM, LC, cumulative OCI on liabilities, acquisition cash to be recovered) on transition much easier and would also improve the relevance of the estimates.

53 On the other hand, users are concerned that depending on the transition methodology applied and assumptions retained upon transition, the measure of future performance could be significantly affected for a long period of time. Some are requesting a reduction of options.

54 We however support the view that different approaches allow for the most relevant and practicable solution to be applied in a context of major changes in the industry. In addition, many disclosures are required to provide information to users on estimates and judgments.

55 We support the application of retrospective approaches. In the insurance business, transactions are rarely performed on a quoted market so that fair value is difficult to gather and generally pertains to level 3 valuations that probably require as much judgment and assessments (and as few comparability) as applying a retrospective approach. We therefore do not consider that the fair value approach should take precedent on any retrospective approach.

56 Our understanding is that the FRA is very demanding. The concern has been raised that the simplifications introduced by the MRA may not result in much less efforts than the FRA. In order to facilitate a retrospective application rather than a prospective approach the MRA should therefore be as flexible as possible.

57 We concur with the principle set in IFRS 17.C6 that the MRA aims at achieving "the closest outcome to retrospective application possible using reasonable and supportable information available without undue cost or effort".

58 We expect the practice to develop in this area (and the reference to "supportable information" invites to such a development). However, we think that either in the FRA or in the MRA, it would be very useful that the standard more clearly states how estimates (which might relax a too strict application) may be used in FRA before being considered as a departure requiring applying the MRA or the FVA. Questions on how to use "reasonable and supportable" information under the FRA or MRA are key, for instance when determining the initial value or when applying annual cohort requirements.

<u>Contracts acquired through a business combination or a portfolio transfer before transition</u>

59 According to IFRS 17.B93, accounting classification (VFA, General Model/BBA, PAA) has not to be made according to initial conditions (e.g. when the contract was issued) but on the date of the transaction (e.g. business combination or portfolio transfer).

60 Furthermore, contracts acquired in their settlement period before transition are treated as contracts providing coverage for the adverse development of claims, and revenue reflects the entire expected claims.

61 On transition, since no specific relief has been provided in the MRA nor in the VFA, these treatments would lead to a:

- Complex assessment of the accounting classification (BBA vs. VFA; BBA vs. PAA) depending on:
  - the date of transfer of a contract (compared with the date of issuance);
  - when a claim arose (whether before or after the transfer);

- possible distortion in the presentation or calculation of KPI (i.e. revenue on claims acquired).

Other transition issues

62 There is a common expectation that IFRS 4 amendment on IFRS 9 exemption will be deferred in order to be aligned with the postponed implementation of IFRS 17.

2.2 Possible accounting mismatches

63 Following 3 issues have been identified for possibly creating accounting mismatches:

- On transition, when applying the OCI option, OCI on liabilities has to be set to nil for non-VFA participating contracts;
- Risk mitigation cannot be applied retrospectively.
- IFRS 9 provisions on financial instruments derecognised in prior year deter from restating comparative financial statement;

OCI option for non VFA participating contracts under the MRA

64 For an entity that chooses to disaggregate insurance finance income or expenses between P&L and OCI in accordance with IFRS 17.88 (b), the MRA requirements indicate that the cumulative OCI relating to non-VFA contracts at the transition date should be assessed as nil under the assumption that the discount rate retained is the current rate on transition (IFRS 17.C19(b)(ii)).

65 From an economic standpoint, there is an issue in considering that changes in discount rate have not yet been recognised on the asset side (measured at amortised cost of FVOCI), whereas the insurance liability would be recognised on transition at a current value, e.g. implicitly considering that past changes in discount rate have been recorded in the retained earnings.

66 Not considering any impact of the OCI carried forward on the liabilities could significantly impact the result of future periods and then undermine the credibility of the transition which is a higher risk than the risk of hindsight created by accepting to retrospectively calculate former FCF.

67 In our view, transition requirements should not only provide a solution to VFA contracts (as IFRS 17.C19(b)(iv) does) but more broadly to participating contracts (as defined in IFRS 17.B132) that are “directly” (i.e. with a clearly identified linkage) linked with assets without complying with all the VFA criteria set in IFRS 17.B101. This would allow for a more continuous accounting treatment of participating contracts preventing the “cliff effect” of VFA criteria.

68 We note that IFRS 17.116 assumes that there is such a link between OCI on assets and liabilities upon transition, even for non VFA contracts.

69 For instance that linkage could be based on a “constructive obligation” not meeting the IFRS 17.B101 criteria or a reinsurance contract issued (such as “Prefon”).

70 In our view reference to a general pool of assets is possible. A pool of assets that would be smaller than the liability is probably not usual; it would however not disqualify but limit to that extent the OCI referred to upon transition.

71 The adjustment would only take into consideration the share in the referred assets that belongs to the policyholders (without considering the entity’s share). Assessing that adjustment probably requires an estimation of historical flows / changes in the FCF in order to estimate the proper amount of OCI to be adjusted.

72 FCF could be discounted at the rate the entity is expecting to be committed to against its policyholders (the “*crediting rate*”). Accordingly, accretion of the liability would reflect the returns transferred to policyholders. From an economic standpoint, the difference between that rate (estimated at transition date) and the current date on

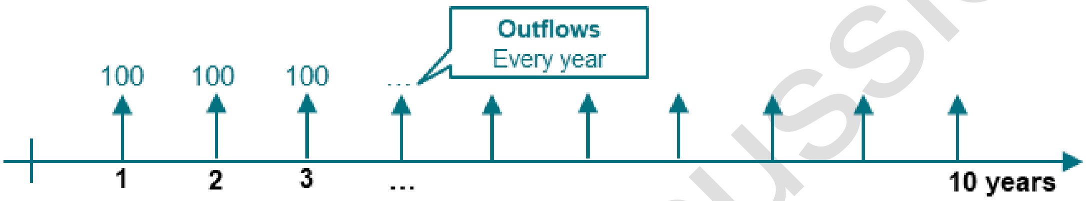
transition could be a proxy of what would have been put in OCI, be IFRS 17 applied from inception. The example below illustrates that alternative.

Illustrative example – Recalculating OCI on transition for non-VFA participating contracts

Assumptions

73 Assuming an indirect participating contract with :

- A fixed income portfolio backing liabilities with a book yield of 5 % (cumulative OCI on assets equal to 107)
- IFRS 17 current discount rate at transition date of 2.5 %
- Policyholders' participation rate of 80%
- Expected cash-outflows of 100 during 10 years (Inforce only, i.e. no New Business)



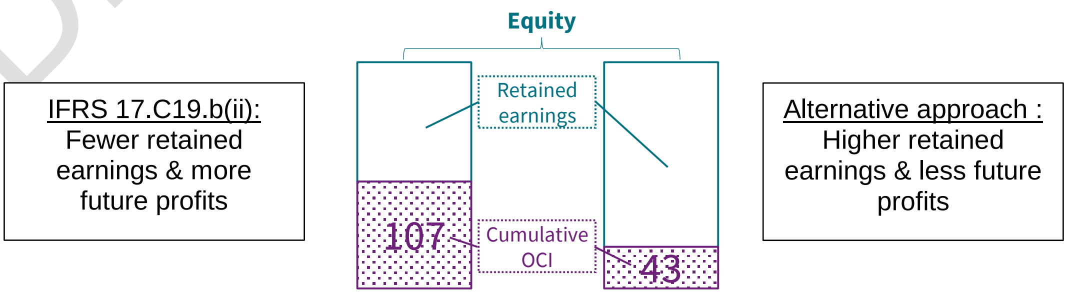
Amount of cumulative OCI at transition

74 Applying the simplification offered by the standard (IFRS 17.C19.b(ii)):

- Cumulative OCI on the asset side (107) results from the difference between the market value at 2.5% current rate (918) and the amortised cost of the asset applying the 5.0% discount rate at inception (811=100+100/(1,05^1)+…+100/(1,05^9))
- Cumulative OCI on liability is set to 0 at transition.
- Net cumulative OCI amounts to 107-0=107

75 Alternative approach: OCI with a "crediting rate" (expected rate of return to policyholders according to IFRS 17.B 134) amounting to 4 % (i.e. 5 %*80%).

- Cumulative OCI on the asset side (107)
- Cumulative OCI on liability (64) results from the outflows at 2.5% current rate subject to a crediting rate of 4%
- Net cumulative OCI then amounts to 43 (107 – 64).

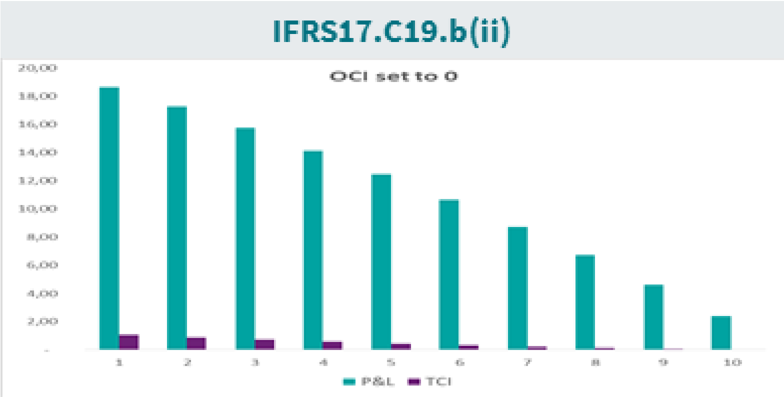


76 The amount of cumulative OCI at transition has:

- no impact on equity (but on the breakdown between OCI and retained earnings);
- a potential major impact on retained and future results.

Focus on the P&L

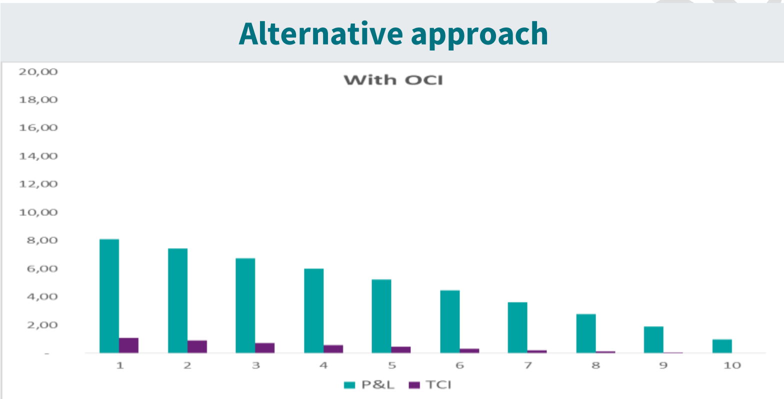
77 The comprehensive income (net result +OCI) remains unchanged.



78 The effective yield on the liability is the current discount rate (2.5 %). Since the effective yield is much lower than the book yield (5 %), the insurance finance expense will be low and the investment result high.

79 There is no allowance for past assets/liabilities interactions.

80 Future investment results are too high (above any economical vision)



81 The crediting rate amounts to 4 %. Since this effective yield is closer to the investment return (5 %), the insurance finance expense will be higher and the investment result lower.

82 The investment result is more in line with the expected financial margin (1 % in our example). In this example all the service provided is linked to investment return services (e.g. no insurance coverage).

83 In its February meeting (see also § 39), IASB discussed two possible solutions but not the one suggested above in this paper.

<u>Interaction with IFRS 9 – Risk mitigation</u>

84 Risk mitigation provisions in IFRS 17.B115 allows for recording in the P&L instead of in the CSM the financial risk's component of changes in the CSM, in order to match the corresponding changes in the derivatives. Retrospectively apply such risk mitigation on transition would accordingly impact the CSM and the retained earnings.

85 However IFRS 17.C3(b) specifically prohibits a retrospective application of risk mitigation that may "give rise to the risk of hindsight" (IFRS 17.BC 393).

86 Conversely, in our view, not reflecting it on transition could distort the historical CSM and significantly impact the insurance result for years.

87 In our view, the documentation on the risk-management objective and strategy for using derivatives to mitigate financial risk arising from the insurance contracts referred to in IFRS 17.B116 may already exist prior to the transition.

88 There is no conceptual reason for excluding the retrospective application of IFRS 17.B115 as long as the same documentation requirement applies. In our view, there is a higher risk to not provide a fair view in not considering any impact of risk mitigation carried forward than in accepting the risk of hindsight to carry forward existing risk mitigation instruments.

89 Moreover, risk mitigation is derived from a corporate strategy and does not result from a deliberate choice. An overall consistency with information provided in other parts of the previous reports could be additionally required: description of the hedging strategy and its major impact, clear distinction between instruments providing risk mitigation and the related contracts, and those that do not provide such a risk mitigation.

90 Moreover, the reference made in IFRS 17.C6 to "reasonable and supportable information available without undue cost or effort" should be a general principle ensuring an adequate financial information in the very specific and temporary situation of a transition.

91 In its March meeting, IASB tentatively decided that risk mitigation could apply prospectively from the transition date on. This may provide a solution limited to the effect of the risk mitigation during the comparative period, but not addressing the opening effect on CSM and retained earnings.

92 IASB has tentatively decided in its January 2019 meeting that the risk mitigation's provisions would apply to proportionate reinsurance held. Accordingly, the risk mitigation issue on transition has been extending to proportionate reinsurance held.

<u>Interaction with IFRS 9 – Comparative information in 2021</u>

93 Applying IFRS 9 provisions, an entity deciding to restate the comparative year 2021 will have to apply both standards (i) IAS 39 on financial instrument derecognised before transition and (ii) IFRS 9 on financial instrument that *have not* been derecognised before transition.

94 Restating the comparative period provides more relevant information, but applying both standards would be operationally burdensome and conceptually inconsistent so that it would deter preparers from choosing that option.

95 There is no conceptual reason for providing a relief on the retrospective application of IFRS 9 to financial instrument that have been derecognised before transition. It is a practical expedient that aimed at facilitating the transition on a standalone basis i.e. where no further collateral impact would arise. By contrast, when applied at the same time as IFRS 17, this provision leads to undue complexity when restating comparative year 2021.

96 In its April meeting, IASB suggested that an application of IFRS 9 could mitigate the issue. Since the issue stems from the non-alignment of transition dates between IFRS 9 and IFRS 17 (which also justified the IFRS 4 amendment) we are not convinced that an earlier adoption of IFRS 9 would actually solve the issue.

3 Suggested solution (tentative)

3.1 Suggested modifications relating to operational complexities –MRA

General

97 There is no need for a detailed guidance on how to apply the principle set in IFRS 17.C8.

98 We are however very supportive of the suggestion made in February's board meeting (IASB 2019-02.AP 2D §36) to explain that a retrospective approach (either FRA or MRA) does not prohibit from making estimates and further to clarify to which extent an estimates stops and becomes a departure to the retrospective approach. This explanation would be better placed in the standard itself.

99 For instance, applying a mixed approach on transition: full retrospective as long as reasonable and supportable information is available (i.e. for the last 10 years) and a FVA as initial value for the period before.

Suggested modifications

100 IFRS 17.C8: To achieve the objective of the modified retrospective approach, an entity is permitted to use each modification in paragraphs C9–C19 only to the extent that an entity does not have reasonable and supportable information to apply a retrospective approach. In addition, the existence of specified modifications in the modified retrospective approach does not prohibit an entity from:

(a) making estimates that are necessary in retrospectively applying an accounting policy as described in paragraph 51 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors; or

(b) similarly, making estimates when applying a specified modification in the modified retrospective approach.

3.2 Suggested modifications relating to operational complexities – contracts acquired through a business combination or a portfolio transfer before transition

General

101 Introducing specific transition provisions (whatever the methodology retained) on the possibility to classify:

- groups of acquired contracts (BBA vs. VFA; BBA vs. PAA) as of the date of issuance instead of the date of transfer;
- as "liabilities for incurred claims" claims acquired in their settlement period before transition.

Suggested modifications

102 IFRS C5bis: On transition and regardless of the approach retained, an entity may depart from IFRS 17.B93 in applying the date when the contract was issued instead of the date of the transaction (e.g. business combination or portfolio transfer) to contracts acquired before transition.

3.3 *Suggested modifications relating to possible accounting mismatches – OCI option*

<u>General</u>

103 We suggest amending IFRS 17.C19(b) so that transition requirements address the cumulative amount of OCI carried forward on the liability for participating contracts (as defined in IFRS 17.B132) that are "directly" (i.e. with a clearly identified linkage) linked with assets without complying with all the VFA criteria set in IFRS 17.B101.

104 FCF should be discounted at the rate the entity is expecting to be committed to against its policyholders. Accordingly, accretion of the liability would reflect the returns transferred to policyholders. From an economic standpoint, the difference between that rate (estimated at transition date) and the current date on transition could be a proxy of what would have been put in OCI, be IFRS 17 applied from inception (as illustrated in the example in § 73-82).

<u>Suggested modifications</u>

105 IFRS 17.C19: For groups of insurance contracts that do not include contracts issued more than one year apart:

(a) if an entity applies paragraph C13 to estimate the discount rates that applied at initial recognition (or subsequently), it shall also determine the discount rates specified in paragraphs B72(b)–B72(e) applying paragraph C13; and

(b) if an entity chooses to disaggregate insurance finance income or expenses between amounts included in profit or loss and amounts included in other comprehensive income, applying paragraphs 88(b) or 89(b), the entity needs to determine the cumulative amount of insurance finance income or expenses recognised in other comprehensive income at the transition date to apply paragraph 91(a) in future periods. The entity shall determine that cumulative difference:

(i) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B131—if the entity applies paragraph C13 to estimate the discount rates at initial recognition—using the discount rates that applied at the date of initial recognition, also applying paragraph C13;

(ii) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B132 <u>— on the basis of the difference at transition date between the current rate and the rate based on which the entity expects to determine its commitment under the contract (*crediting rate*); otherwise</u> on the basis that the assumptions that relate to financial risk that applied at the date of initial recognition are those that apply on the transition date, ie as nil;

(iii) for insurance contracts for which an entity will apply the methods of systematic allocation set out in paragraph B133—if the entity applies paragraph C13 to estimate the discount rates at initial recognition (or subsequently)—using the discount rates that applied at the date of the incurred claim, also applying paragraph C13; and

(iv) for insurance contracts with direct participation features to which paragraph B134 applies—as equal to the cumulative amount recognised in other comprehensive income on the underlying items.

3.4 Suggested modifications relating to possible accounting mismatches – Interaction with IFRS 9 – Risk mitigation

General

106 We suggest removing the prohibition introduced in IFRS 17.C3(b) of a retrospective application of the risk mitigation provisions.

Suggested modifications

~~107~~ IFRS 17.C3: An entity shall apply IFRS 17 retrospectively unless impracticable, except that ~~:~~

~~(a)~~ an entity is not required to present the quantitative information required by paragraph 28(f) of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.~~; and~~

~~(b) an entity shall not apply the option in paragraph B115 for periods before the date of initial application of IFRS 17.~~

3.5 Suggested modifications relating to possible accounting mismatches – Interaction with IFRS 9 – Comparative information in 2021

General

108 We suggest making optional the exception introduced in IFRS 9.7.2.1 regarding financial instruments derecognised during the comparative period.

109 For consistency reasons, this should apply to all qualifying items and not on an item by item basis.

Suggested modifications

110 IFRS 9.7.2.1: An entity shall apply this Standard retrospectively, in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, except as specified in paragraphs 7.2.4–7.2.26 and 7.2.28. An entity opts whether t~~T~~his Standard ~~shall~~ ~~not be~~ applie~~d~~s or not to all items that have already been derecognised at the date of initial application.