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Insurance Accounting Alert

May 2018

Second technical discussion of the IASB's IFRS 17 Transition Resource Group (TRG)

What you need to know

- The second technical discussion of the IASB's TRG took place on 2 May 2018.
- The TRG discussed five IASB staff papers on specific issues submitted to the Board.
- The TRG was also asked to confirm whether an outreach report on certain implementation challenges reflected their input fairly.
- IASB staff responses to twelve further issues raised were summarised and reported to the TRG.
- TRG members expressed disagreement with the IASB staff view that insurance services are the only service that an entity takes into account when releasing the CSM for contracts accounted for under the general model. This is particularly important for participating contracts that do not meet the criteria for the variable fee approach where expected profits from investment services can form a significant proportion of the CSM.
- TRG members felt that the staff summary of certain operational challenges arising from the implementation of IFRS 17 did not reflect the full scale, complexity and potential expense of the issues identified and the limited perceived value of the outcome.
- The TRG will discuss, at a future meeting, submissions regarding IFRS 17 issues faced by mutual insurers and whether IFRS 17 should apply to certain contracts typically issued by non-insurance entities.
- The next TRG meeting will be held on 26 September 2018.

Background

IFRS 17 *Insurance Contracts* (IFRS 17 or the standard) represents a fundamental change to accounting practice for entities issuing insurance contracts and is expected to require significant implementation effort. Therefore, as one of the activities to support implementation of IFRS 17, the International Accounting Standards Board (IASB or the Board) has set up a Transition Resource Group (TRG).

The purpose of the TRG is to:

- Provide a public forum for stakeholders to follow the discussion of questions raised on implementation
- Inform the IASB in order to help it determine what, if any, action will be needed to address the questions raised. Possible actions include providing supporting materials such as webinars, case studies and/or referral to the Board or IFRS Interpretations Committee

The TRG comprises experts directly involved in the implementation of IFRS 17: nine members are preparers of financial statements and six are audit practitioners. Three further members with observer status represent international security regulators, insurance supervisors and actuarial organisations. The TRG does not issue authoritative guidance, but the IFRS Foundation publishes summaries and recordings from the TRG's meetings on the IASB's website. The comments from the TRG discussion presented in this publication do not reflect formal interpretations or authoritative guidance.

The second TRG meeting held to discuss implementation issues occurred on 2 May 2018. To date, the IASB has received 49 submissions, although some submissions have been combined so that the number of issue papers is less than the number of submissions. At the February 2018 meeting, 18 issues were discussed in detail by the TRG or considered by the IASB staff but not required to be discussed in detail by the TRG. At the May 2018 meeting:

- Five issues were discussed in detail by the TRG.
- One paper was presented for the TRG to confirm whether an outreach report on certain implementation challenges accurately reflected their comments.
- Twelve issues were considered by the IASB staff, but not discussed in detail by the TRG as the IASB staff believe that these are matters which:
  - Can be answered by applying only the wording in IFRS 17

    Or
  - Are being considered through a process other than a TRG discussion (such as a proposed annual improvement)
- One issue was referred back to the submitter for further information.
- Two issues (both on mutual entities) were deferred pending further analysis by the submitting entity.
- An issue regarding the scope of IFRS 17 and whether it should include contracts typically issued by non-insurance entities will be considered at a later meeting, following further outreach to better understand the nature of the contracts and how they are accounted for today.

The five Issues discussed in detail by the TRG

The IASB staff had prepared detailed papers on each of the five submissions that were discussed by the TRG. The TRG discussed the implementation question and members shared their views and understanding as industry experts. At the end of each discussion, the IASB staff summarised the key points made during the discussions.

1. Combination of insurance contracts

The question

When would it be necessary to treat a set or series of insurance contracts together as one single contract, applying paragraph 9 of IFRS 17? Paragraph 9 of IFRS 17 reads, as follows:

"A set or series of insurance contracts with the same or a related counterparty may achieve, or be designed to achieve, an overall commercial effect. In order to report the substance of such contracts, it may be necessary to treat the set or series of contracts as a whole. For example, if the rights or obligations in one contract do nothing other than entirely negate the rights or obligations inanother contract entered into at the same time with the same counterparty, the combined effect is that no rights or obligations exist."

The IASB staff paper notes the following:

- The fact that a set, or series, of insurance contracts with the same counterparty are entered into at the same time is not, in itself, sufficient to conclude that they achieve, or are designed to achieve, an overall commercial effect.
- Determining whether it is necessary to treat a set, or series, of contracts as a single contract involves significant judgement and consideration of all relevant facts and circumstances.
- While no single factor is determinative in applying this assessment, if the lapse or maturity of one contract causes the lapse or maturity of another contract, there is a strong indication that the contracts were designed to achieve an overall commercial effect.
- It is expected that entities would usually design contracts in a way that reflects their substance, so a single contract in form is likely to be a single contract in substance. However, there may be circumstances when they are designed to achieve an overall commercial effect.

- The existence of a discount (e.g., a price reduction offered to a policyholder who purchases more than one insurance contract) does not in itself mean that a set or series of contracts achieve an overall commercial effect. The overall commercial effect of such contracts looked at in combination may not be any different to the commercial effect when looked at separately if the discount is allocated appropriately to each of the contracts.
- IFRS 17 does not prescribe how to allocate discounts, but paragraph BC 112 of IFRS 17, which cross-refers to IFRS 15, suggests an approach that an entity could take.

Points made during TRG discussion

TRG members think of the principles for the combination of contracts as the mirror image of those for separating insurance components from a single insurance contract. The existence of a discount does not necessitate the combination of contracts and it should not preclude separation of insurance components that form part of a single contract. Both are subject to the general expectation that entities would usually design contracts in a way that reflect their substance.

Several members welcomed the staff observation that the existence of a discount did not, in itself, imply that contracts should be combined. Some questioned whether the fact that contracts lapse together should be considered as more convincing evidence that contracts were issued to achieve an overall objective.

A few members felt that contracts that were required to be combined under paragraph 9 of IFRS 17 should have been issued reasonably close together in time. Both the example in the staff paper and that listed in paragraph 9 refer to contracts entered into at the same time. A member noted that a policyholder might purchase an annuity many years after purchasing a life insurance contract; the effect of the contracts might partially offset each other. However, TRG members did not think they should be combined.

How we see it

The guidance provided by the IASB staff, and the TRG's discussion of it, will be helpful in determining when individual contracts should be combined. It is also in line with the guidance provided in the February TRG for when contracts should be separated into different insurance components that would, in substance, represent separate contracts.

2. Determining the risk adjustment for non-financial risk in a group of entities

The question

At what level should the risk adjustment for non-financial risk be determined in respect of contracts issued by an entity that is part of a group of entities that prepare consolidated financial statements?

In particular, is the risk adjustment for non-financial risk determined considering the degree of diversification available at the group of entities level or the individual entity level?

The IASB staff paper stated that the risk adjustment for non-financial risk for a group of insurance contracts should be the same at the consolidated level as at individual entity level. Applying paragraph B88, an entity must only reflect diversification in determining the risk adjustment to the extent that this diversification is considered when determining the compensation that the entity would require for bearing non-financial risk related to insurance contracts issued by the entity.

Paragraph B88 of IFRS 17 states, as follows:

"Because the risk adjustment for non-financial risk reflects the compensation the entity would require for bearing the non-financial risk arising from the uncertain amount and timing of the cash flows, the risk adjustment for non-financial risk also reflects:

a. The degree of diversification benefit the entity includes when determining the compensation it requires for bearing that risk; and

b. Both favourable and unfavourable outcomes, in a way that reflects the entity's degree of risk aversion."

Points made during TRG discussion

There were differing views about whether the risk adjustment for financial risk for a group of entities in consolidated financial statements should be the sum of those of the subsidiaries or should reflect the group's perspective of risk and the compensation it requires for bearing risk.

A few TRG members were attracted by the simplicity of there being one single risk adjustment for each group of insurance contracts – with no need for separate records at group and entity level. Others felt it was unwarranted to prohibit a group from having a different risk adjustment from the sum of its subsidiaries. Some TRG members noted that the term "entity" should, in their view, be interpreted as referring to the reporting entity rather than the entity issuing insurance contract. The reporting entity is different for group consolidated financial statements and individual entity financial statements. While it might be expected in most circumstances that the risk adjustments would be the same between the entity and the group, they might not always be so and these members did not feel that the words in IFRS 17 prohibited a difference.

There were also differences of opinion amongst TRG members about the meaning of the final sentence of paragraph B87:

> **"… As a result, the risk adjustment for non-financial risk conveys information to users of financial statements about the amount charged by the entity for the uncertainty arising from non-financial risk about the amount and timing of cash flows."**

Some thought that the use of the word 'charged' referred to the pricing actually performed by the entity that issues a contract and, therefore, relates to the perspective of the entity that sets the price of the contract (issuing entity). Others thought "charged" meant the cost of bearing risk that an entity attributes to a contract and is not necessarily the amount included in the premium. These members noted that linking "charged" to actual pricing was inconsistent with the objective of the risk adjustment to reflect the compensation that the entity would require for bearing non-financial risk. This was therefore a theoretically determined amount. It was noted that it is unusual for insurers to explicitly split any premium charged to a policyholder into an amount charged for bearing non-financial risk and an amount charged for other risks or services. As such, the amount attributed to a contract could differ depending on which entity is making the attribution.

An IASB Board member noted that whether the risk adjustment for financial risk reflects the risk perception of the group or is the sum of the amounts in standalone financial statements of subsidiaries cannot be a choice. The two views cannot coexist.

How we see it

The TRG discussion was not conclusive, with different views being expressed by TRG members, Board members and the staff. TRG members appeared to accept that an individual entity would consider group diversification when setting a risk adjustment if this was considered in determining the compensation that the entity required for bearing risk. However, there was no agreement on whether that implied that the risk adjustment at the group consolidated level had to be the same as that at the entity level. It is not clear whether the IASB staff will bring back this topic for further discussion.

3. Cash flows within the contract boundary

The question

How to apply the definition of a contract boundary contained in paragraph 34 of IFRS 17. In particular:

a. how to interpret the practical ability to set a price at a future date that fully reflects the risk of a contract or portfolio from that date; and

b. how to consider options to add additional insurance coverage into an existing contract.

On Question A, the IASB staff paper stated that any constraint that applies equally to new contracts and existing contracts would not limit an entity's ability to reprice existing contracts to fully reflect their reassessed risks. However, if an entity has the practical ability to reassess the risk presented by the policyholder, but does not have the right to set a price that fully reflects the reassessed risk, then the contract still binds the entity. An entity must consider contractual, legal and regulatory restrictions and ignore restrictions that have no commercial substance. Sources of constraints may also include market competiveness and commercial considerations, but constraints are irrelevant to the contract boundary if they apply equally to new and existing policyholders in the same market.

On Question B, the IASB staff believe that paragraph B62 is clear that an option to add insurance coverage is a feature of an insurance contract that is not measured separately. Paragraph B62 of IFRS 17 states the following:

> **"Many insurance contracts have features that enable policyholders to take actions that change the amount, timing, nature or uncertainty of the amounts they will receive. Such features include renewal options, surrender options, conversion options and options to stop paying premiums while still receiving benefits under the contracts. The measurement of a group of insurance contracts shall reflect, on an expected value basis, the entity's current estimates of how the policyholders in the group will exercise the options available, and the risk adjustment for non-financial risk shall reflect the entity's current estimates of how the actual behaviour of the policyholders may differ from the expected behaviour …"**

The options should be measured on an expected value basis. For options with guaranteed terms, the IASB staff believe it is clear that these are within the contract boundary because the insurer does not have repricing ability. For options with non-guaranteed terms, whether cash flows are within the contract boundary depends on whether the insurer has the practical ability to reprice the whole contract (including the option) that fully reflects the reassessed risk. If so, the cash flows from the option are outside the contract boundary.

Points made during TRG discussion

TRG members generally agreed with the IASB staff analysis on Question A.

On Question B, several TRG members commented they had difficulty understanding how a policyholder option to add insurance coverage that an entity could price to fully reflect the policyholder risk at the time the option is invoked could represent a substantive obligation of the entity before the option is exercised. Accordingly, these TRG members had difficulty accepting that such options would be included within the contract boundary of an existing contract.

The IASB staff explained that the paper discussed at this meeting is based on the presence of an option that is assumed to represent a substantive obligation to the entity. What constitutes substantive rights and obligations from options for future coverage is a separate matter that, according to the IASB staff, could usefully be debated by the TRG at a future meeting. The staff also noted that an entity would first determine whether the option represented, in substance, a separate contract, applying the guidance on separation of insurance components within a contract from the February 2018 TRG meeting. If that were the case, then the cash flows from that option would not fall within the contract boundary of the existing contract, but would be treated as a separate contract with its own contract boundary.

How we see it

There was clarification in both the IASB staff paper and the TRG discussion that the boundary of an insurance contract is determined as the point at which the insurer can reprice the entire contract to fully reflect the risks. This means that, for contracts with multiple insurance coverages, the boundary is determined by the point at which the entity would have been able to (re) price to fully reflect the risks resulting from the contract in its entirety.

There was some concern from TRG members that the requirement to include expected cash flows for 'non-guaranteed' options not yet taken up by policyholders would require a significant amount of estimation, and would not necessarily provide useful information. This is particularly the case if these options were to be entered into at the market price at an uncertain future time, therefore, making them little different from new contracts with new customers. The IASB staff added that this would only apply if the grant of the option conferred substantive rights and obligations, but did not go into further discussion of when rights and obligations under an option would be substantive.

4. Boundary of reinsurance contracts held with repricing mechanisms

The question

How should the contract boundary of a reinsurance contract held be determined when the reinsurer has the right to reprice existing coverage prospectively after a three month notice period, but the cedant is committed to continue paying premiums unless the reinsurer exercises its right to reprice?

In the fact pattern provided, the reinsurer can choose whether or not to reprice the contract. If the reinsurer does reprice the contract, then the cedant has the right to terminate coverage. However, if repricing is not exercised, then the cedant is compelled to pay the premiums agreed under the contract.

Paragraph 34 of IFRS 17 discusses contract boundaries, as follows:

> **"Cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity can compel the policyholder to pay the premiums or in which the entity has a substantive obligation to provide the policyholder with services (see paragraphs B61–B71) …"**

The IASB staff paper noted that, based on the fact pattern presented, the entity has no substantive right to receive service from the reinsurer after the first three months of coverage because at any time, with three months' notice, the reinsurer has the practical ability to reassess the risks and can set a price level for benefits that fully reflects the reassessed risk. Therefore, whether or not the contract boundary extends beyond the three months of coverage depends on whether the entity has a substantive obligation to pay amounts to the reinsurer. The entity is compelled to pay premiums to the reinsurer after the three month notice period if the reinsurer does not increase premium rates. This is not in the control of the entity and therefore the entity has a substantive obligation to pay amounts to the reinsurer for the full contract term (i.e., the duration of the underlying insurance contracts).

Points made during TRG discussion

TRG members agreed with the IASB staff analysis, but several noted that the fact pattern was a very specific example.

How we see it

Given the comment that the fact pattern reflects a very specific example, the (re) insurance industry may be looking for further guidance on how to determine the boundary of reinsurance contracts with termination rights subject to a notice period when the right to receive coverage and the obligation to provide coverage extends as time passes and termination rights are not invoked. The fact pattern in this paper did not address this issue. Determining the contract boundary of this kind of open-ended contract is likely to be addressed at a future TRG meeting.

5. Determining the quantity of benefits for identifying coverage units

The question

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 the expected coverage duration (IFRS 17 para B119).

How should the "quantity of benefits" referred to in paragraph B119(a) of IFRS 17 be defined when considering different groups of contracts, The paper divides the different types into those including an investment component and those excluding investment components.

The IASB staff paper continued the coverage unit discussion on insurance contracts without investment components from the February 2018 TRG meeting and also discussed insurance contracts with investment components. A total of 16 examples of insurance contracts were examined. The paper reiterated the observations from the February paper that coverage units:

- Reflect the likelihood of insured events occurring only to the extent that they affect the expected duration of the contracts in the group
- Do not reflect the likelihood of insurance events occurring to the extent that they affect the amount expected to be claimed in the period

The staff paper considers points that are relevant to the following:

- To insurance contracts both with and without investment component
- Only to insurance contracts without investment components
- Only to insurance contracts with investment components

Observations related both to insurance contracts with and without investment components include:

- The period in which an entity bears risk is not necessarily the same as the coverage period, as contracts may be recognised before the period actually begins.
- Judgement will be required in assessing the quantity of benefits provided by contracts in a group where the contracts making up that group provide different types of benefit.
- Determining coverage units to reflect service is not an accounting policy choice but involves judgement and estimates to best reflect the provision of service — which should be determined systematically and rationally — with reference to paragraph 125 of IAS 1 *Presentation of Financial Statements*.

Observations related only to insurance contracts without investment components.

- The IASB staff paper amended the staff views, previously expressed in February 2018, to reflect the comments made at that meeting. The staff observed that the wide variety of types of insurance cover and the different ways they are combined requires a principles-based approach and that it is not possible to set detailed requirements that will apply appropriately to a wide variety of products. For example, for insurance contracts without investment components, the staff believe that possible methods to determine the quantity of benefits include the use of: (a) the maximum contractual cover in each period; and (b) the amount the entity expects the policyholder to be able to validly claim in each period if an insured event occurs.

Observations related to insurance contracts with investment components.

- The IASB staff believe that the requirements on this question differ for insurance contracts with direct participation features (accounted for under the variable fee approach, (VFA in IFRS 17)) and insurance contracts without direct participation features (accounted for under the general model). Because VFA contracts provide both insurance services and investment-related services, the staff believe that the expected coverage duration of services recognised under IFRS 17 relates to both insurance and investment-related services. The paper proposed a narrow-scope amendment to IFRS 17 to modify the definition of the coverage period for VFA contracts to make this principle clear. However, for general model contracts, coverage units and the coverage period should be determined by reference to insurance services only.

Points made during TRG discussion

Several TRG members referred to the usefulness of examples in the paper to help to illustrate particular points, but noted the danger of applying the approach in the examples by analogy to similar but different contracts. There was widespread agreement with the observation in the paper that guidance must be principles-based and reliant on judgement, provided that judgement is applied in a systematic and rational way. Some were concerned by the potential variety and complexity of approaches in the examples. One TRG member suggested a rebuttable presumption that one could release the contractual service margin (CSM) on the basis of the passage of time, with other methods being available if the passage of time did not give a fair reflection of the service provided. Another TRG member suggested that allocating the CSM based on the amount the entity expects the policyholder to be able to validly claim in each period if an insured event occurs could be a "universal principle" to apply.

Several TRG members questioned the assumption that coverage units do not reflect the likelihood of insured events occurring to the extent that they affect the amount expected to be claimed in the period. One gave the example of a liability insurance contract that provides cover of CU1m for events that can occur over 12 months and cover of CU100m for events that can occur over four years. Events subject to the higher amount of cover might be very unlikely to occur and so it is the CU1m cover that should have more weighting. The TRG member felt that allocating the CSM evenly over four years would give the wrong information about the level of service provided to policyholders. The IASB staff acknowledged that the likelihood of an insured event occurring could be relevant in weighting the amounts of insurance coverage provided where a single contract contained insurance components.

One TRG member noted that he did not agree that, at the February meeting, all TRG members had accepted the principle noted in the paper that the quantity of benefits provided in a coverage period did not reflect the likelihood of insurance events occurring.

TRG members welcomed the acknowledgement that contracts eligible for the VFA provide investment-related services as well as insurance services and that the CSM should be released in a way that reflects the provision of both services. However, there were significant concerns about the 'cliff effect' caused by the difference in CSM allocation for contracts eligible for the VFA and other contracts that TRG members feel provide a similar mix of investment-related and insurance services, if allocation of the CSM under the general model can only reflect the provision of insurance coverage.

A number of TRG members noted that they interpreted paragraph B119 of the IFRS 17 to allow allocation of the CSM to reflect investment-related services for all contracts and believe this could be a solution to what they perceive as a significant problem for contracts that provide policyholders with an investment return that do not qualify for the VFA (commonly referred to as 'indirect participating contracts'). A few other TRG members noted that the requirement to adjust the CSM for the effect of changes in discretion in paragraph B98 could be read as being equivalent to adjusting the CSM for changes in expected investment performance. However, there were mixed views amongst the TRG members on the interpretation of the meaning of coverage in paragraph B119 and whether it could be read to relate to both insurance and investment services.

Accordingly, TRG members expressed differing views on whether there would be a need to amend the standard to allow a CSM release according to investment-related services for VFA contracts. Some members noted that, if the IASB was willing to make the proposed narrow scope amendment to the standard for VFA contracts, perhaps it should consider amending the standard to allow other contracts to also consider both insurance and investment services in determine the pattern of CSM amortisation.

Several TRG members noted that the measurement of the CSM at initial recognition for contracts in which a proportion of the returns on underlying assets are paid to policyholders (indirect participating contracts) reflects the spread between expected earnings on the underlying assets and the amounts expected to be paid to policyholders. They noted that this sometimes forms a very significant part of the CSM determined at inception. It would, therefore, be misleading if this CSM was released to income over a different period from that in which the assets are invested and returns are paid to policyholders. This could be the case if the insurance services in those contracts where provided over a different time period.

How we see it

The TRG members welcome the principle set out in the paper that different methods may be used to determine the quantity of benefits provided for a group of contracts as long as they achieve the objective of reflecting the insurance service provided in each period. However, there was no consensus on whether the standard did or should allow the recognition of coverage based on both insurance and investment services for contracts that were not in the scope of the VFA.

It is not clear how the IASB will choose to seek to resolve this open question.

The IASB Staff summarised the TRG discussion, as follows:

For contracts without investment components

- A principles-based approach should be followed to show service provided.
- There is a need to be careful with examples as they represent judgements on very specific fact patterns and may not be generally applicable to similar examples.
- TRG members felt that the IASB staff should reflect the comments that the likelihood of an event occurring may provide evidence of coverage when there are multiple services in a group.
- The standard implies that reasonable proxy methods can be applied to determine services provided in a period.
- There is a need to apply systematic and rational judgement.
- TRG members thought that consideration should be given to allowing straight line amortisation over time a reasonable proxy for the provision of service.

For contracts with investment components:

- There was agreement that VFA contracts provide investment-related services and that these services should be reflected in the CSM release.
- Strong views were expressed that some types of contracts accounted for under the general model often do provide investment-related services.
- Differing views exist on whether a change to the standard is required.
- If the standard were to be amended, different views exist on what such a change would be.
- There are different understandings of what an investment-related service is and how it is measured.

6. Implementation challenges outreach report

The question

TRG members were asked to comment on whether the IASB staff's outreach paper accurately reflected the implementation concerns raised by the TRG in February 2018 in respect of:

- Presentation of groups of insurance contracts in the statement of financial position
- Identifying premiums received related to groups of contracts – particularly applying the premium allocation approach
- Subsequent treatment of insurance contracts acquired in their settlement period

The IASB staff intend to provide this report to the IASB at a future meeting.

Points made during TRG discussion

Several TRG members commented that the report fails to convey the scale, complexity, and expense of the issues raised and the extent to which the provided information would, in their view, not be useful or actually be misleading. There was a clear view from these members that the operational cost of applying the aspects of the standard listed above was not worth the benefit. Several TRG members confirmed that the issues raised in the paper are amongst their top three implementation issues, but that there were a number of other issues. One TRG member noted that the list is not the result of a systematic review of the issues. That TRG member also highlighted issues for reinsurers arising from the collection of net data in systems today. TRG members also commented that the remedies suggested in the paper of education, additional disclosure, and approximation were inadequate.

The staff agreed to amend the summary to reflect the comments of the TRG members. One of the Board members also suggested that it would be made clear to the IASB that these implementation issues arose as a result of questions submitted to the TRG and that there could, therefore, be a number of other significant implementation issues that had not been identified and brought to the attention of the Board.

How we see it

Many TRG members welcomed the efforts of the IASB staff to better understand the implementation concerns raised and the intention to share the detail of these with the IASB. However, it is not clear what further actions the IASB will take in response to these. In addition, TRG members made it clear that there are a number of other implementation concerns that have not been raised through the TRG question submission process. It is not clear whether these issues will also be reported to the IASB.

7. Twelve issues submitted to the TRG, but not discussed in detail

Below are the questions with the responses of the IASB staff in italics. The reference at the beginning of each paper is to the number of the question on the TRG submission log.

Questions that the IASB staff believe can be answered applying only the wording in IFRS 17

S13: applying the full retrospective approach to transition. Whether reasonable approximations are permitted when applying IFRS 17 retrospectively, or whether the existence of specified modifications in the modified retrospective approach suggests that other modifications should not be used when applying IFRS 17 retrospectively.

Staff response: *applying Para C5 of IFRS 17, an entity shall apply IFRS 17 retrospectively unless impracticable. IAS 8 provides guidance on whether retrospective application is impracticable.*

S14: whether "risk neutral" or "real world" scenarios should be used for stochastic modelling techniques to project future returns on assets applying Para B48 of IFRS 17?

Staff response: *applying Para B48 of IFRS 17, an entity is required to apply judgment to determine the technique for estimating market variables to meet the objective of achieving consistency with observable market variables.*

S28: there appear to be two different definitions of the adjustments to the contractual service margin for insurance contracts with direct participation features, specifically Para 45(b) and Para B112.

Staff response: *the adjustment to the contractual service margin should provide the same mathematical outcome in both definitions. The staff will consider this topic for future educational materials.*

S29: applying Para B72 (e) (i) of IFRS 17 for a group of insurance contracts for which changes in assumptions that relate to financial risk do not have a substantial effect on the policyholders, should an entity use an effective yield rate or a yield curve?

Staff response: *IFRS 17 does not mandate the use of an effective yield rate or a yield curve as long as the rate is the rate that applies to nominal cash flows that do not vary based on underlying items, applying Para 36.*

S32: (a) When are claims incurred for issued adverse loss cover and contracts acquired in their settlement period because service has been provided? (b) For contracts acquired in their settlement period, what subsequent treatment should be applied if the contractual service margin is Nil at initial recognition and estimates of future cash outflows decrease subsequently?

Staff response: *(a) Applying Para B5 the claims are incurred when the financial effect becomes certain. This is not when the entity has a reliable estimate if there is still uncertainty involved. Conversely, this is not necessarily when the claims are paid if certainty has been achieved prior to the actual payment. (b) For insurance contracts acquired, subsequent measurement, including changes in estimates that adjust the contractual service margin is the same as for insurance contracts issued applying Paras 40–52. Therefore, a contractual service margin larger than zero may be recognised post acquisition.*

S35: how should "no significant possibility" be interpreted (in the context of no significant possibility of becoming onerous)? Can the concept of significant insurance risk be applied by analogy?

Staff response: *the term "no significant possibility" should be interpreted in the context of the objective of the requirement. "No significant possibility of becoming onerous" is different from "significant insurance risk" and the concept of significant insurance risk should not be used by analogy.*

S37: is an entity's estimate of future economic conditions ever required to estimate future cash flows (e.g., the non-market variables that correlate to market variables applying Para B53)?

Staff response: *para B48 requires an entity to use judgement to determine the technique for estimating market variables to meet the objective of achieving consistency with observable market variables. An entity is not required to divide estimated cash flows into those that vary based on the return on underlying items and those that do not.*

S38: is it required that the effect of minimum guarantees is reflected by adjusting the discount rate (and not through adjustments to the cash flows)?

Staff response: *IFRS 17 requires that the time value of a guarantee is reflected in the measurement of the fulfilment cash flows. However, it does not require the use of a specific approach to do this. Per B86, financial risk is included in estimates of the future cash flows or the discount rate used to adjust the cash flows. The technique used must result in the measurement of any options and guarantees being consistent with observable market prices for such options and guarantees.*

S40: what discount rate should be used to measure the present value of future cash flows of a reinsurance contract held if the liquidity characteristics of the underlying contracts are different from those of the reinsurance contract held?

Staff response: *para B63 only requires use of consistent assumptions to measure estimates of the present value of future cash flows for the group of reinsurance contracts held and the estimates of the present value of the future cash flows for the group of underlying insurance contracts to the extent that the same assumptions apply to both the underlying contract and the reinsurance contracts held. If different assumptions apply for the reinsurance contract held then the entity uses those different assumptions when measuring that contract.*

S41: for reinsurance contracts held, are coverage units determined based on the services provided by the reinsurer or the coverage units of the underlying insurance contracts?

Staff response: *for reinsurance contracts held, the quantity of coverage is the coverage received by the insurer from those reinsurance contracts held and not the coverage provided by the insurer to its policyholder through the underlying insurance contracts. The staff referred to Example 8 of Agenda Paper 5 when an example of proportional reinsurance coverage is considered.*

S42: for reinsurance contracts held, is the risk of non-performance of the issuer of the reinsurance contract considered with the estimates of the present value of the future cash flows or the risk adjustment for non-financial risk?

Staff response: *para 63 explicitly states that the effect of any risk of non-performance by the reinsurer is included in estimates of the present value of future cash flows.*

Questions that the IASB staff believe did not meet the TRG submission criteria

No submissions reported in this category.

Questions that are being considered through a process other than by TRG discussion

S33: does IFRS 17 apply to certain contracts typically issued by banks? These contracts have been grouped by the IASB staff into three categories:

- Loan contracts that may waive some or all of the payments due in specific circumstances;
- Service contracts involving a form of EBITDA guarantee
- Credit card contracts providing coverage for supplier failure.

Staff response: *in general, a contract that is an insurance contract under IFRS 4 is expected to continue to be an insurance contract under IFRS 17. However, the accounting implications of IFRS 17 are different. The IASB staff intend to conduct outreach to determine how these contracts are currently accounted for.*

What's next?

The next meeting of the TRG will be held on 26 September 2018.

Look out for further publications from EY on IFRS 17, which will be published over the coming months.

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