Actuaries Institute

AASB 17 Insurance Contracts

Addendum A

to

Information Note Version 1.2

February 2019

This Addendum A should be considered alongside the Information Note version 1.2 published in December 2018.

It addresses changes to IFRS 17 the IASB tentatively agreed to at its January and February 2019 meetings. The exposure draft setting out the IASB's proposed wording changes to IFRS 17 is yet to be released, so this Addendum relies on the papers presented to the IASB and records of the subsequent discussions at the IASB.

It assumes that corresponding changes will be made to AASB 17 once IFRS 17 has been formally changed, following exposure of the exact changes proposed, and consideration of feedback by the IASB.

A new Version of the IN will be produced in due course. In the meantime, this Addendum provides the reader of the IN with the current position.

AASB 17 IN Version Control

<table>
<tr><th>Version</th><th>Key changes</th><th>Effective date</th></tr>
<tr><td>1.0</td><td>AASB 17 Information Note Version 1.0 - draft for discussion</td><td>March 2018</td></tr>
<tr><td>1.1</td><td>Version 1.1 is not a draft, but the first operating version. The main changes reflect clarification on various aspects through IASB processes and TRG papers and feedback in Australia. In particular:
More clarity on premium received rather than accrued
Revision of treatment of expense cash flows, including allocation of fixed and variable overheads and acquisition costs
More detail on the level at which diversification benefits apply for risk adjustment purposes
More detail on coverage units
More clarity on treatment of contractual options
More detail on derecognition</td><td>July 2018</td></tr>
<tr><td>1.2</td><td>Version 1.2 is an update of Version 1.1. A number of refinements and clarifications have been made, following feedback, questions and improved understanding, with the main changes being as follows:
A Preface has been added. This provides more context and amongst other matters explains how areas of uncertainty are being addressed.
To provide ready access to details of areas of uncertainty, a new Section 15 (Interpretation Uncertainties) has been added. This includes five tables on:
areas where judgement will need to be applied;
areas where an accounting choice will need to be made;
areas where consequences have been identified, but there is unlikely to be a change;
areas where the IASB seems to be open to changing the Standard; and</td><td>December 2018</td></tr>
</table>

Version	Key changes	Effective date
	- areas where there is still uncertainty in interpretation, but the Standard is unlikely to change. • Updates which have been made where previously uncertain areas have been clarified (e.g. IASB September TRG); and • Various editorial clarifications have been made.	
Addendum A to Version 1.2	This Addendum A provides changes to what is set out in Version 1.2 of the IN as a consequence of tentative decisions of the IASB at its January and February 2019 meetings.	February 2019

Background to this Addendum

The AASB 17 Information Note Version 1.2 (the IN) was issued in December 2018.

In the Preface and in Section 15, the IN noted that there were various areas of uncertainty. These included the possibility that the IASB would agree to certain changes to IFRS 17, as proposed by a number of different industry and professional bodies around the world. They included changes supported by the AASB 17 TRG.

In the Preface to the IN, there is a table showing the various changes which the AASB 17 TRG asked the IASB to consider. It also showed the outcome of the IASB December 2018 meeting.

The outcomes of the December meeting are addressed in Version 1.2.

In January and February 2019, after Version 1.2 was issued, the IASB considered various recommendations put forward by IASB staff.

This Addendum addresses changes to IFRS 17 agreed to by the IASB at its January and February 2019 meetings. The exposure draft setting out the IASB's proposed wording changes to IFRS 17 is yet to be released, so this Addendum relies on the papers presented to the IASB and records of the subsequent discussions at the IASB.

It assumes that corresponding changes will be made to AASB 17 once IFRS 17 has been formally changed, following exposure of the exact changes proposed, and consideration of feedback by the IASB.

Changes Tentatively Agreed by IASB

The following is an update of the table in the Preface to Version 1.2, taking into account the changes tentatively agreed by the IASB in January and February 2019, as well as comments made on other issues considered at the time.

AASB 17 TRG Response to IASB October 2018 Board Agenda ref 2D Together with IASB Dec 2018, Jan 2019 and Feb 2019 Outcomes

Strongly support change | Outcome not a priority for Australia | Strongly disagree with change

Topic	Australian Response		AASB TRG agree with IASB staff preliminary assessment?	IASB 2018 Meeting Outcomes (incl. in 1.2)	IASB Jan & Feb 2019 Meeting Outcomes (not in 1.2)
1 – Scope of IFRS 17 | Loans and other forms of credit that transfer insurance risk	Support a change	Change	Yes	Not addressed	Change: Choice of IFRS 9 or IFRS 17
2 – Level of aggregation of insurance contracts	Agree that no change is required – subject to addressing the concerns in Topic 15	No change		Not addressed	Not addressed
3 – Measurement | Acquisition cash flows for renewals outside the contract boundary	Support a change but not considered one of the top two issues in Australia	Change	Yes	Not addressed	Change: defer direct acquisition cost associated with future renewal
4 – Measurement | Use of locked-in discount rates to adjust the CSM	Support a change	Change	No	No change	
5 – Measurement | Subjectivity | Discount rates and risk adjustment	Agree that no change is required	No change	Yes	No change	
6 – Measurement | Risk adjustment in a group of entities	Agree that no change is required	No change	Yes	No change	
7 – Measurement | Contractual service margin: coverage units in the general model	Support a change	Change	Yes	Not addressed	Change: investment service now to be included in calculation of coverage units

8 – Measurement | Contractual service margin: limited applicability of risk mitigation exception	Not expected to have a significant impact in Australia	N/A	N/A		No change	Change: Extend to reinsurance held
9 – Measurement | Premium allocation approach: premiums received	Implementation challenges will be mitigated if Topic 15 is addressed	No change	No		No change	
10 – Measurement | Business combinations: classification of contracts	Agree that no change is required	No change	Yes		No change	
11 – Measurement | Business combinations: contracts acquired during the settlement period	Support a change but not considered one of the top two issues in Australia	Change	No		No change	
12 – Measurement | Reinsurance contracts held: initial recognition when underlying insurance contracts are onerous	Support a change. One of the top two issues identified in Australia	Change	Yes		Not addressed	Change: allow CSM for proportional reinsurance held to offset loss from onerous underlying contracts
13 - Measurement | Reinsurance contracts held: ineligibility for the variable fee approach	Not expected to have a significant impact in Australia	N/A	N/A		Not addressed	No change
14 - Measurement | Reinsurance contracts held: expected cash flows arising from underlying insurance contracts not yet issued	Support a change but not considered one of the top two issues in Australia	Change[1]	No		No change	

[1] The AASB TRG noted that this is a top priority issue for a smaller group of insurers in Australia who have long term reinsurance contracts covering short term underlying insurance contracts.

15 – Presentation in the statement of financial position | Separate presentation of groups of assets and groups of liabilities	Support a change. One of the top two issues identified in Australia	Change	Yes		Change: separate presentation now at portfolio level	
16 – Presentation in the statement of financial position | Premiums receivable	Implementation challenges will be mitigated if Topic 15 is addressed	No change	N/a		No change	
17 – Presentation in the statement(s) of financial performance | OCI option for insurance finance income or expenses	Agree that no change is required. This would disrupt implementation projects significantly	No change	Yes		No change	
18 – Defined terms | Insurance contracts with direct participation features	Not expected to have a significant impact in Australia	N/A	N/A		No change	
19 – Interim financial statements | Treatment of accounting estimates	Agree that no change is required in respect of the concerns raised in AP2D	No change	Yes[2]		No change	
20 – Effective date | Date of initial application of IFRS 17	N/A – tentative decision made in the November Board meeting to defer	N/A	N/A		Defer to 1 January 2022	
21 – Effective date | Comparative information	Agree that no change is required	No change	Yes		Not addressed	No change

[2] However, the AASB TRG considers that the IAS 34 override in IFRS 17 should be permitted but not required.

22 – Effective date | Temporary exemption from applying IFRS 9	N/A – tentative decision made in the November Board meeting to defer	N/A	N/A		Exemption now to 2022	
23 – Transition | Optionality	Agree that no change is required	No change	Yes		Not addressed	No change
24 – Transition | Modified retrospective approach: further modifications	Support a change	Change	Yes		Not addressed	Change: for liabilities that relate to the settlement of claims incurred before an insurance contract was acquired
25 – Transition | Fair value approach: OCI on related financial assets	Agree that no change is required	No change	Yes		Not addressed	No change

IASB Updates – January and February 2019

Following each of its meetings in January and February 2019, the IASB issued updates to explain the outcomes of various proposals for change.

Relevant extracts from those updates are provided below.

January 2019 Update

The Board met on 23 January 2019 to consider possible amendments to IFRS 17 relating to the following topics:

a) insurance acquisition cash flows — Agenda Paper 2A;

b) reinsurance contracts held — Agenda Papers 2B, 2C and 2D; and

c) recognition of the contractual service margin in profit or loss — Agenda Paper 2E.

Insurance Acquisition Cash Flows for Renewals outside the Contract Boundary (Agenda Paper 2A)

The Board tentatively decided to amend IFRS 17 to **require** an entity to:

a) allocate to any expected contract renewals their related part of the insurance acquisition cash flows directly attributable to newly issued contracts;

b) recognise the insurance acquisition cash flows allocated to expected contract renewals as assets applying paragraph 27 of IFRS 17 until the renewed contracts are recognised;

c) assess the recoverability of any asset recognised applying paragraph 27 of IFRS 17 each period before the related contracts are recognised. The recoverability assessment would be based on the expected fulfilment cash flows of the related group of contracts;

d) recognise a loss in profit or loss for any unrecoverable carrying amounts of the asset recognised by applying paragraph 27 of IFRS 17; and

e) recognise in profit or loss the reversal of some or all of any such loss previously recognised when the impairment conditions no longer exist or have improved.

Reinsurance Contracts Held (Agenda Papers 2B, 2C and 2D)

The Board tentatively decided to amend IFRS 17 to:

a) expand the scope of the exception in paragraph 66(c)(ii) of IFRS 17 to require an entity to recognise a gain in profit or loss when the entity recognises losses on onerous underlying insurance contracts, to the extent that a reinsurance contract held covers the losses of each contract on a proportionate basis; and

b) require an entity to apply the expanded exception when the entity measures contracts applying the premium allocation approach (PAA).

The Board also tentatively decided to amend IFRS 17 to expand the scope of the risk mitigation exception for insurance contracts with direct participation features in paragraph B115 of IFRS 17 so that the exception applies when an entity uses a derivative or a reinsurance contract held to mitigate financial risk, to the extent that the entity meets the conditions in paragraph B116 of IFRS 17.

Recognition of the Contractual Service Margin in Profit or Loss in the General Model (Agenda Paper 2E)

The Board tentatively decided:

a) to amend IFRS 17 so that in the general model the contractual service margin is recognised in profit or loss on the basis of coverage units that are determined by considering both insurance coverage and investment return service, if any;

b) to amend IFRS 17 to establish that an investment return service exists only when an insurance contract includes an investment component;

c) to amend IFRS 17 to require an entity to use judgement applied consistently in deciding whether an investment return service exists when determining coverage units, and not provide an objective or criteria for that determination. However, the Board instructed the staff to consider including in the Basis for Conclusions some of the analysis in the Board paper, to indicate what such judgements might involve;

d) to amend IFRS 17 to establish that the period of investment return services should be regarded as ending when the entity has made all investment component payments to the policyholder of the contract and should not include any period of payments to future policyholders;

e) to amend IFRS 17 to require assessments of the relative weighting of the benefits provided by insurance coverage and investment return services and their pattern of delivery to be made on a systematic and rational basis;

f) to confirm that, applying IFRS 17, cash flows relating to fulfilling the investment return service are included in the measurement of the insurance contract;

g) not to change the requirements of IFRS 17 relating to changes in fulfilment cash flows that adjust the contractual service margin in the general model; and

h) to amend IFRS 17 to establish that the one-year eligibility criterion for the PAA should be assessed by considering insurance coverage and an investment return service, if any.

February 2019 Update

The Board met on 7 February 2019 to consider possible amendments to IFRS 17 relating to the following topics:

a) loans that transfer significant insurance risk — Agenda Paper 2A; and

b) transition — Agenda Papers 2B, 2C and 2D.

Loans that transfer significant insurance risk (Agenda Paper 2A)

The Board tentatively decided to amend the scope of IFRS 17 and IFRS 9 Financial Instruments for insurance contracts that provide insurance coverage only for the settlement of the policyholder's obligation created by the contract. These amendments would enable entities issuing such contracts to account for those contracts applying either IFRS 17 or IFRS 9. The choice would be made portfolio by portfolio, using the IFRS 17 definition of a portfolio.

Transition — Optionality and comparative information (Agenda Paper 2B)

The Board tentatively decided to:

a) retain the IFRS 17 transition requirements without making amendments that would reduce the optionality included in those requirements; and

b) retain the IFRS 17 requirement to present restated comparative information for the annual reporting period immediately preceding the date of initial application of IFRS 17.

Transition — Risk mitigation option and amounts accumulated in other comprehensive income on transition (Agenda paper 2C)

The Board tentatively decided to retain the transition requirement in IFRS 17 that prohibits retrospective application of the risk mitigation option.

The Board asked the staff to continue to explore alternative proposals that would address stakeholders' concerns about the results of not applying the option retrospectively.

The Board also tentatively decided to retain the transition requirements in IFRS 17 relating to the cumulative amounts included in other comprehensive income.

Transition — Modified retrospective approach (Agenda paper 2D)

The Board tentatively decided to:

a) retain the transition requirements in the modified retrospective approach set out in IFRS 17 that:

    i. prohibit an entity from using a specified modification to the extent that the entity has reasonable and supportable information to apply the related IFRS 17 requirement retrospectively; and

    ii. permit an entity to use a specified modification only when the entity has reasonable and supportable information to apply that modification.

b) retain the transition requirements in IFRS 17 for the modified retrospective approach, without an amendment that would permit an entity to develop its own modifications that it regards as consistent with the objective of the modified retrospective approach. However, 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;

c) amend the transition requirements in IFRS 17 for liabilities that relate to the settlement of claims incurred before an insurance contract was acquired as follows.

- To add a specified modification to the modified retrospective approach so that an entity classifies such liabilities as a liability for incurred claims. Consistent with the other specified modifications, an entity would be permitted to use this specified modification only to the extent that it does not have reasonable and supportable information to apply a retrospective approach.
- To permit an entity applying the fair value approach to choose to classify such liabilities as a liability for incurred claims.

d) retain without amendment the specified modification in the modified retrospective approach relating to the use of cash flows that are known to have occurred, instead of estimating retrospectively cash flows that were expected to occur; and

e) retain the modified retrospective approach for insurance contracts with direct participation features, without an amendment that would permit an entity to apply to such contracts the specified modifications permitted for insurance contracts without direct participation features.

Next Steps after January and February IASB Meetings

At future meetings the Board will consider the topics from Agenda Paper 2D *Concerns and implementation challenges* for the October 2018 Board meeting that have not yet been discussed. After the Board has considered each topic individually, the Board plans to consider the package of amendments at a future meeting. At that meeting the Board will consider whether:

a) any amendments to the disclosure requirements are required as a result of the amendments tentatively decided by the Board;

b) on the whole, the benefits of the amendments outweigh the costs; and

c) on the whole, the amendments do not unduly disrupt implementation.

At the end of the February meeting, the Board noted that it will continue its discussions on possible amendments to IFRS 17 at future meetings.

Changes to Answers in the IN

The IN is generally structured as a series of questions and answers.

In light of the decisions made by the IASB at its January and February 2019 meetings, some answers will need to be changed. While the IN itself has not yet been altered, the following altered answers should be noted:

Q3.28 How are insurance acquisition cash flows considered if paid prior to initial recognition of the related group of insurance contracts?

Under the definition in AASB 17 Appendix A, insurance acquisition cash flows only include those that are directly attributable to the portfolio of insurance contracts. Hence, prima facie, those that aren't should be expensed as per other standards – probably immediately. At its January 2019 meeting, the IASB made a tentative decision to **require** part of the insurance acquisition cash flows that is directly attributable to newly issued contracts to be allocated to future renewals that have not been recognised. Should this proceed, then:

- the part so allocated would be recognised as an asset until the renewed contracts are recognised, per AASB 17.27; and
- recoverability of this asset needs to be assessed based on the expected fulfilment cash flows related to the expected future renewals and if impaired the impact needs to be recognised in profit and loss. Note, any such impairment may be reversed, if recoverability subsequently improves.

An asset (or liability) is recognised for any insurance acquisition cash flows paid (or received) prior to initial recognition of the GIC to which they relate. This asset (or liability) is derecognised when the related GIC is recognized, and the insurance acquisition cash flows are then gradually expensed over the coverage period. (See AASB 17.27 – note that although AASB 17.27 refers *to group of **issued** insurance contracts*, at the IASB Feb 18 TRG staff clarified that the reference to ***issued*** in IFRS 17.27 was there purely to distinguish from reinsurance held and not a requirement that there are contracts actually issued in the related GIC.)

However, where the option under AASB 17.59(a) is exercised, the costs are also immediately expensed when they are incurred.

Q6.11 What is a coverage unit?

Coverage unit is defined by AASB 17.B119(a) as:

> *The number of coverage units in a group is the quantity of coverage provided by the contracts in the group, determined by considering for each contract the quantity of the benefits provided under a contract and its expected coverage duration.*

The interpretation of this was discussed initially at the IASB's Feb 18 TRG paper AP05 and considered further and in more depth at the IASB's May 18 TRG paper AP05 and May TRG Meeting Summary). It was observed that:

- IFRS 17 established principle, not detailed requirements, and detailed requirements would not work appropriately in all cases;

- determination of coverage units is not an accounting policy choice, but requires application of careful judgement and consideration of the facts and circumstances to best achieve the principle of reflecting the services provided in each period;
- the analysis of the examples in paper AP05 reflects the fact pattern of each example and does not necessarily apply to other fact patterns;
- in considering how to achieve the principle, it was observed by the TRG members that:
    - lapse expectations are included to the extent they affect expected duration of coverage;
    - the different levels of service across periods needs to be reflected in determination of coverage units;
    - the quantity of benefits is determined from the policyholder perspective not the quantity of benefits expected to be incurred by the insurer;
    - a policyholder benefits from the insurer standing ready to meet valid claims should the insured event occur, hence the quantity of benefits relates to amounts that can potentially be claimed;
    - different probabilities of insured events across periods do not of themselves affect the stand-ready quantity of benefit provide to a policyholder, but where there are different types of insured events, their different probabilities might affect the stand-ready benefit provided by the insurer;
    - particular method or methods are not specified by IFRS 17 and different methods may achieve the objective of reflecting the service provide in each period;
    - the following methods may be reasonable proxies depending on the facts and circumstances:
        - (i) straight line allocation over time but reflecting the number of contracts in the group;
        - (ii) use of maximum contract cover in each period;
        - (iii) use of expected valid claim amounts each period should insured event occur;
        - (iv) use of premiums, but not if they:
            - are receivable in different periods to the insurance services; or
            - reflect different probabilities of claim for the same insured event in different periods rather than different levels of stand-ready service; or
            - different levels of profitability in contracts rather than the stand-ready service.
        - (v) use of expected cash flows, but not if they result in no allocation of CSM to periods in which the insurer is standing ready

The IASB May 18 TRG paper AP05 also considered the question of what services should be reflected, e.g. purely insurance or insurance and investment, and the staff analysis concluded that:

- IFRS 17 identifies VFA contracts as providing both insurance and investment services;
- the reference to services in IFRS 17.45 and IFRS 17.B119 relate to insurance and investment service;
- the reference to quantity of benefits in IFRS 17.B119(a) relates to both insurance and investment services;
- the reference to expected coverage duration in IFRS 17.B119(a) relates to the duration of insurance and investment services; and
- it is necessary, given the tight link of the coverage period to the provision of coverage of insured events in IFRS 17, to make a narrow amendment to clarify that for VFA coverage period relates also to the provision of investment services.

Members of the TRG generally did not agree with the view that investment service was only present for VFA and argued that this was also present for non-VFA. Some also believed that coverage could be interpreted more widely than insurance without the need to an amendment to IFRS 17.

At its January 2019 meeting, the IASB made a tentative decision to amend IFRS 17 so that for the general model, ***coverage units*** are determined by considering both insurance coverage and investment return service, if any. Should this proceed, then:

- an investment return service will be deemed to exist only when an insurance contract includes an investment component;
- both the insurance coverage and investment return service will need to be considered and the relative weighting of the benefits provided by each assessed (allowing appropriately, for their pattern of delivery). This would need to be done on a systematic and rational basis in order to determine the amount of contractual service margin to be released each period;
- the period of investment return services would be regarded as ending when the entity has made all investment component payments to the policyholder and would not include any period of payments to future policyholders;
- in doing this, any judgement in deciding whether an investment return service exists would need to be applied consistently when determining coverage units. The IASB is not expecting to provide any objective criteria for any such determination, but may include in the Basis for Conclusions some of the analysis in the January 19 Board paper, to indicate what such judgements might involve.

The following aspects of AASB 17 and the IFRS 17 Basis for Conclusions remain relevant in interpreting coverage unit, particularly ***insurance coverage***:

- The ***coverage period*** which is also defined in AASB 17, Appendix A as:

  The period during which the entity provides coverage for insured events. This period includes the coverage that relates to all premiums within the boundary of the insurance contract.

  - The ***insured event*** in turn is defined as

    An uncertain future event covered by an insurance contract that creates insurance risk.

  - The ***insurance risk*** in turn is defined as

    Risk, other than financial risk, transferred from the holder of a contract to the issuer.

    The application guidance (AASB 17.B7-B32) makes clear what constitutes insurance risk.

- The recognition of CSM in insurance revenue as being related to the transfer of services (AASB 17.44 and AASB 17.45):

  the amount recognised as insurance revenue because of the transfer of services in the period, determined by the allocation of the contractual service margin remaining at the end of the reporting period (before any allocation) over the current and remaining coverage period, applying paragraph B119.

- The Basis of Conclusions (IFRS 17.BC279-BC282) which sets out the IASB's thinking and rationale for the release of the CSM and the use of coverage units for this purpose. In particular, the following were discussed and **rejected** by the IASB as the basis for release of the CSM:
  - pattern of expected cash flows (IFRS 17.BC279(a));
  - the change in the risk adjustment caused by release from risk (IFRS 17.BC279(a));
  - when the returns on investment components occur even where this drives total expected fee (IFRS 17.BC280); and
  - release based on services other than insurance service (Last sentence of IFRS 17.BC280)

The appendices of the IASB's May 18 TRG paper AP05 contain a large number of examples and IASB staff's analysis of potential views of what coverage unit means in the context of specific facts and circumstances. These can be helpful in understanding the principles noted above.

Often where a contract has a range of covers (e.g. reinsurance treaty), a common view of coverage is necessary.

A potential common unit of coverage across different types of cover are**;**

- where coverage units are defined as the quantity of insurance coverage provided, an interpretation of coverage units that could work across most types of cover would be - the maximum valid amount payable if a claim were to occur for all covers under each contract in the group, e.g:
    - Maximum valid lump sum payable upon claim (gross or net of any investment component depending upon interpretation);
    - sum of the maximum valid regular payments payable upon claim event in coverage period (again net or gross of any investment component).

For example, coverage could be:

- for term life insurance, the sum insured payable upon death;
- for income protection, the sum of the annual income payments if the insured became disabled and remained disabled for the remaining life of the contract;
- for general insurance contracts it could be based on the expected level of cover (e.g. expected maximum valid claim), subject to the limit of indemnity (where applicable) or maximum probable loss – e.g. for property insurance the full limit of indemnity might only be paid if the property is written off, but most claims are for much less.

Note: this interpretation may not be practicable for some contracts. e.g. stop loss insurance.

Unexpected Outcomes – each of these interpretations may lead to unexpected outcomes depending on circumstances, for example:

- excluding the investment component leads to:
    - potentially no release of CSM for lifetime annuities during the term-certain period;
    - much earlier release of CSM for endowments and participating business that does not qualify for VFA.
- Using sum insured instead of:
    - regular premiums leads to earlier recognition of CSM where premium rates increase with age; or
    - expected claims - leads to:
        - earlier recognition of CSM for income protection where claims are paid over time, especially for contracts with longer benefit payment periods; and

- later recognition of CSM for mortgage insurance both life and lender's insurance, where expected claims potentially decline much faster than coverage.

Note that for stand-alone investment contracts with discretionary participation features, the coverage units are based on the investment service, and hence on when the returns on the underlying items occur. Although the way in which this is determined will need to be considered, the subject is not addressed further in this note.

Note also that as underlying business and reinsurance are separate, coverage units need to be determined gross rather than net.

Q7.8 What *facts and circumstances* should be used to determine whether the contracts are measured for onerousness under the PAA approach?

Again, the Standard is not explicit on this matter. It is understood that there also is no strict accounting definition of what *facts and circumstances* mean.

Facts and circumstances is likely to refer to available management information in the form of regular reports, business planning activities, underwriting reviews, industry analysis or commissioned technical analysis that indicate changes in the expected profitability level of a set of contracts. It is also likely to include any relevant information that is known to the entity or easily ascertained, e.g. if some contracts pay such a high level of acquisition commission that that they are onerous (if the future renewals are outside the contract boundary, and so are ignored) then, the Feb 18 TRG discussion of AP04 *Insurance acquisition cash flows paid on an initially written contract,* indicates that these should be grouped as onerous. Note that acquisition costs would not be relevant in assessing whether a group of contracts is onerous if the entity has elected to recognise insurance acquisition cash flows as expenses when it incurs those costs, in accordance with AASB 17.59(a).

At its January 2019 meeting, the IASB made a tentative decision to amend the standard to require an entity to allocate to anticipated contract renewals the part of insurance acquisition cash flows that is directly attributable to newly issued contracts and to recognise an asset until the renewed contracts are recognised. This may affect the assessment of whether the group of contracts is onerous in the example described above. This is because part of the acquisition costs are now to be allocated to the future renewals outside of the contract boundary and would not be recognised in assessing whether the newly issued contract is onerous.

It would appear that if the AASB 17.59(a) option is selected, only the portion of the insurance acquisition cash flows allocated to the current year can be expensed immediately.

Other examples could be if the insurer deliberately ignores a significant rating variable (e.g. gender) in pricing when it is entitled to use it (and hence may be aware of less profitable segments) or where historic groups of insurance contracts are loss making, possibly indicating a deterioration in profitability for more recent groups as well.

The indication could be in the form of a change in trend assumption or the identification of a subset of contracts that is expected to generate different profitability level within a portfolio. It is not expected that a valuation assessment will be performed strictly for the purpose of finding onerous contracts. This is likely to be part of the regular internal management processes, which may be heavily reliant on actuarial experience investigations and analysis of change.

An overarching principle is that the onerous contract tests should be carried out by using *all reasonable and supportable information available without undue cost or effort*.

Q7.12 How are acquisition costs recognised under PAA?

When using the PAA an insurer may either recognise any insurance acquisition cash flows as expenses when it incurs those costs (allowable if coverage is a year or less) or amortise acquisition costs in line with the earning of the premium associated with the contract giving rise to the acquisition costs (AASB 17.59(a)). Amortising of all or part of the acquisition costs cannot be deferred beyond the contract boundary of the initial contract that gave rise to the costs.

At its January 2019 meeting, the IASB made a tentative decision to require an entity to allocate to anticipated contract renewals the part of insurance acquisition cash flows that is directly attributable to newly issued contracts and to recognise an asset until the renewed contracts are recognised. This will mean that some insurance acquisition costs for newly issued contracts will be deferred beyond the contract boundary on products with expected renewals.

Q8.27 How is asymmetry treated for contracts eligible for the VFA?

The estimate of future cash flows shall be an estimate of the probability-weighted mean of the full range of outcomes. Hence, any asymmetry in the possible outcomes would be captured within this estimate of future cash flows. At its meeting in January 2019, the IASB made a tentative decision to expand the scope of the risk mitigation exception for insurance contracts with direct participation features. Should this proceed, the exception would apply not just when an entity uses a derivative but also a reinsurance contract held to mitigate financial risk. Where the risk of asymmetry is hedged, then the value of any risk mitigants may be included in the pool of underlying items, offsetting the value of the assets in that pool. (However, where the value of such risk mitigants is not in the pool of underlying items, then the movement in value of the options and guarantees under the contracts does not have to be offset by a change in the CSM - see **Error! Reference source not found. Error! Reference source not found.**).

Whilst AASB 17 requires an understanding of the full range of potential outcomes, it acknowledges that a variety of methods of calculation could be suitable for arriving at the estimate. These include stochastic modelling, the use of probability distributions and relatively simple modelling.

Q8.28 How do changes in the impact of asymmetry affect profit?

Because the impact of asymmetry is incorporated into the estimate of future cash flows, its impact on profit is the same as for other FCF.

AASB 17 appears to specifically require changes in the value of options and guarantees under contracts eligible for the VFA to be offset by changes in the value of the CSM, so long as this margin does not become negative. That is, if the risk of asymmetry is not hedged, then the profit to the entity will be reduced by the value of the options and guarantees under the contracts.

Where the impact of options and guarantees under the contracts is hedged, (see Q 8.27) but such risk mitigants are not in the pool of underlying items, then the movement in value of the options and guarantees under the contracts does not have to be offset by a change in the CSM. This is to avoid an accounting mismatch, where the movement in the risk mitigants goes to profit but the movement in the options/guarantees under the contracts is offset by the CSM.

Under AASB 17, risk mitigants are included in the pool of underlying items if they are shared with policyholders. This would allow the change in the fair value movement in those risk mitigants to offset the movement in other assets.

If risk mitigation is used and the CSM is not adjusted for some changes in the fulfilment cash flows then the impact of this on the CSM must be disclosed (AASB 17.112).

Q8.29 Is there a significant change from current approaches in the treatment of asymmetry?

The required outcomes of both AASB 17 and AASB 1038 are similar and both allow flexibility in the method of calculation. As a result, methods of allowing for options and guarantees under the insurance contracts that are currently used are expected to remain broadly suitable for AASB 17 purposes.

AASB 17 does not contain the shareholder/policyholder delineation that exists within the Life Act. A reserve for asymmetry currently held under AASB 1038 may be outside the participating environment. Accordingly, treatment under AASB 17 is expected to now be simpler (in as much as asymmetry just requires an adjustment to cash flows and CSM) and may not have a material impact on the profit results.

[paragraph deleted]

It is noted that there has been some difference of opinion amongst practitioners in the past (e.g. does AASB 1038 require a reserve in advance or is it sufficient to recognise a loss when the guarantee 'bites'?). Different companies therefore approach the reserve for asymmetry differently. However, it would appear that AASB 17 is more definite in terms of the requirement to hold a reserve in advance for asymmetry: i.e. a reserve also needs to be held for the time value of the equivalent option under the contract.

The potential for overlap between the risk of asymmetry and the need for a Risk Adjustment is also noted. If the asymmetry is related to financial returns (which in most cases it is), then it affects discount rates and / or cash flows, not Risk Adjustment. Given that the risk of asymmetry is likely to be financial, a Risk Adjustment is unlikely to be needed, unless the risk is deemed to arise from the contract terms – see Sub-chapter 8.5 Risk Adjustment.

Q9.8 Is there an offset in reinsurance held when the underlying gross contracts become onerous?

Consider the situation where a change in the FCF of a group of underlying contracts does not adjust the CSM of the underlying GIC (e.g. becomes onerous or is already onerous and becomes more or less so). This could occur due to changes in assumptions relating to future service. In this case, the corresponding change in cash flows for the reinsurance held does not adjust the CSM of the reinsurance held under AASB 17.66(c) (see also IFRS 17.BC315). Thus, the net effect on the profit or loss in the period reflects the impact of the reinsurance held.

Note that this only applies **after** inception, but not if the underlying contract is onerous at initial recognition. Even though the losses at initial recognition on the underlying contract are immediately recognised, any gains from the reinsurance cannot be used to offset those losses, but a CSM for the reinsurance must be set up instead. (See Q9.7 Does reinsurance have a CSM? and Q9.9 Does the existence of reinsurance held impact the determination of the CSM or onerous contract testing of the gross policy liabilities?) This is likely to be the subject of future TRG discussion.

In these circumstances it is also possible that the offsetting impact on the reinsurance held may exceed that on the underlying contracts if, due to its contract boundary, the reinsurance ceded cash flows include expected renewals on the underlying contracts but the gross does not.

AASB 17.66(c) applies when the reinsurance cash flows related to underlying contract does not adjust the CSM of the underlying. A question then arises when the underlying does not currently have CSM:

- due to it being measured using PAA; or
- because it relates to the underlying expected future new business that falls within the boundary of the reinsurance contract, and hence currently does not have CSM.

There are two views on this:

A) **Only when the underlying group is onerous** is the reinsurance CSM not adjusted. The argument for this is that:

(i) it is consistent with the rationale given by IASB that where an underlying group becomes onerous due to changes in estimates for future service then the reinsurance CSM should not be adjusted, creating an offset (IFRS 17.BC315).

(ii) Estimates for future service only occur under PAA when the portfolio is onerous (see AASB 17.57-58).

(iii) Criteria for not adjusting reinsurance CSM under AASB 17.66(c) are that there is a change in underlying FCF for future service and such change does not adjust the CSM of the underlying group. The equivalent of such change only occurs under PAA when contracts are onerous, as otherwise underlying FCF are not measured under PAA.

(iv) This also applies where the underlying future insurance contracts are within the boundary of the reinsurance contract and are expected to be onerous, e.g. future contracts arising from the renewal of annual stepped premium insurance where each renewal is treated as a new contract under AASB 17.

B) **The reinsurance CSM is never adjusted** when the change in reinsurance FCF relates to either an underlying portfolio using PAA or future underlying within the boundary of reinsurance contract, even when the underlying cash flows are not onerous as:

(i) there is no CSM under PAA, so any change to reinsurance cash flows relating to an underlying portfolio do not adjust the CSM of the underlying portfolio; and

(ii) the criteria in AASB 17.66(c) does not require an actual change in FCF for the underlying portfolio, just that the change in FCF of the reinsurance contract relates to the underlying portfolio and does not change the CSM of the underlying portfolio. In particular, AASB 17.66(c)(ii) simply requires that:

> *the change results from a change in fulfilment cash flows allocated to a group of underlying insurance contracts that does not adjust the*

contractual service margin for the group of underlying insurance contracts.

Further FCF arising from future underlying new business within the contract boundary of the reinsurance do not adjust CSM of the group of underlying contracts as they have not yet been recognised nor measured. The wording used in AASB 17.66(c)(ii) "*does not*" rather than "would not" implies that AASB 17.66(c)(ii) only applies to current underlying and not future underlying within the reinsurance contract boundary.

At its January 2019 meeting, the IASB made a tentative decision to expand the scope of the exception in IFRS 17.66(c)(ii) for proportionate reinsurance. Should this proceed, then the analysis of AASB 17.66(c)(ii) above will only apply to non-proportionate reinsurance. For proportionate reinsurance, it is expected that IFRS 17 will require an entity:

- to recognise a gain in profit or loss when the entity recognises losses on onerous underlying insurance contracts; and
- to apply the expanded exception when the entity measures contracts applying the premium allocation approach (PAA).

Of the two views above, only view A is likely to be consistent with expected amendments to IFRS 17 for proportionate reinsurance, and even then wording of IFRS 17.66(c)(ii) will need to be amended somehow so that changes in reinsurance FCF that relate to expected future underlying onerous PAA contracts are not released into profit and loss when the change in reinsurance FCF occurs but when the underlying PAA losses are recognised.

Q12.12 What areas are permitted to be modified?

The following areas can be modified (AASB 17.C7-8):

- assessments of insurance contracts or GIC that would have been made at the date of inception or initial recognition;
- amounts related to the CSM or loss component for insurance contracts without direct participation features;
- amounts related to the CSM or loss component for insurance contracts with direct participation features; and
- insurance finance income or expenses.

At its February 2019 meeting, the IASB made a tentative decision to amend the transition requirements for the modified retrospective approach for liabilities that relate to the settlement of claims incurred before an insurance contract was acquired. Should this proceed, a specified modification will be added to the modified retrospective approach so that an entity classifies such liabilities as a liability for incurred claims (only where it does not have reasonable and supportable information to apply a retrospective approach) – notwithstanding the TRG interpretation that IFRS 17 requires such liabilities to be treated as insurance service and not claims settlement).

Q12.25 What other transition modifications apply if using the fair value approach?

The following determinations can be made either at the date of inception, if reasonable and supportable evidence exists, or using information available as at the date of transition:

- identify GIC;
- group together contracts that are more than one year apart;
- whether an insurance contract meets the definition of an insurance contract with direct participation features and so is eligible to use the VFA; or
- the discount rates to be used (at the transition date rather than the date of initial recognition or incurred claim).

At its February 2019 meeting, the IASB made a tentative decision to amend the transition requirements for liabilities that relate to the settlement of claims incurred before an insurance contract was acquired. Should this proceed, then there will be a further option available under fair value. This will allow the insurer, applying the fair value approach, to choose to classify and treat such liabilities as a liability for incurred claims, notwithstanding the TRG interpretation that IFRS 17 requires such liabilities to be treated as provision of insurance service (and not claims settlement).

Chapter 15 Updates

Chapter 15 of the IN provides a set of five tables which set out various areas of uncertainty with respect to the implementation of the standard.

In light of the decisions made by the IASB at its January and February 2019 meetings, some areas of uncertainty have largely been removed.

The following shows changes to Table 3 and 4 in Section 15:

Table 3: Areas where consequences have been identified, but there is unlikely to be a change (or the IASB has decided that there will be no change)

Issue	Description and Implications	References	Related IN Question
Scope of Hedging Adjustment	Whilst IFRS 17 includes a specific hedging adjustment, its use is limited to specific circumstances. • It is only available for contracts in scope of the VFA. • It cannot be applied retrospectively from the date of initial application. • It can only be used when derivatives are used as hedging instruments. Mismatches will result if the fair value changes on hedging instruments are not recognised in the same category (P&L, OCI or CSM) as the changes on the hedged items. This will significantly distort the net result and create misalignment between accounting results and risk management. Paradoxically, a perfect hedge would cause greater volatility in the higher income statement than a partial hedge. The AASB 17 TRG agrees that no change is needed. At their December 2018 meeting, the IASB decided that there would be no change in the applicability of the risk mitigation approach in the VFA model to hedging arrangements other than the use of derivatives. However, at its January 2019 meeting, although the IASB tentatively decided that reinsurance contracts should still not use the VFA, the risk mitigation approach in the VFA model would be extended to include the use of reinsurance. They deferred a decision on the retrospective application of risk mitigation. At its February 2019 meeting, the IASB tentatively decided that the risk mitigation option should not be applied retrospectively.	AASB TRG July 2018 meeting – AP3 CFO Forum October 2018 letter IASB October 2018 meeting – AP2D IASB December 2018 meeting – AP2C IASB January 2019 meeting – AP2D IASB February 2019 meeting – AP2B, 2C and 2D	Q8.25 – Q8.27
Reinsurance – other	In addition to the issue at inception: • Reinsurance held cannot be accounted for under the VFA, even if the VFA is applied to the underlying insurance contracts; • Contract boundaries for reinsurance could be inconsistent with those of the underlying insurance	EFRAG letter to IASB 3/9/2018 AALC August 2018 meeting	Error! Reference source not found. and Error!

Issue	Description and Implications	References	Related IN Question
	contracts. In particular, reinsurance treaties may cover underlying contracts that have not yet been written; • For reinsurance treaties, there could be several benefit types within the same treaty - to what extent are these treaties considered to be "similar risks"? • Changes in FCF estimates for future service don't adjust CSM if they don't adjust CSM of underlying; • The financial statements do not appropriately reflect the net risk position after reinsurance and, as a consequence, a distorted profit recognition pattern could be presented; • Inconsistent contract boundaries mean that reinsurance accounting requires including an estimate of underlying insurance business that is not yet written/recognised; and • Where the underlying contracts use the PAA, changes in future reinsurance fulfilment cash flows are recognised immediately in P&L. The same occurs where future new business is allowed for in the projection of the reinsurance contract as the underlying contracts do not exist. Profit volatility will therefore be amplified. Some members of the IAA have expressed strong support for change. The AASB TRG strongly supported this change. However, at their December 2018 meeting, the IASB decided that there would be no change. At its January 2019 meeting, the IASB tentatively decided that a gain should be recognised in respect of a reinsurance contract held (but only those that cover the losses of each contract on a proportionate basis) when the entity recognises losses on onerous underlying insurance contracts. This should occur **at all times**, even after initial recognition of the reinsurance held. This expanded exception should even apply when the entity uses the PAA.	– Appendix 4, and AALC October 2018 meeting – AP4b) CFO Forum October 2018 letter **IASB October 2018 meeting – AP02D** **IASB December 2018 meeting – AP2E** **IASB January 2019 meeting – AP2B**	Reference source not found.
Transition - OCI	The option to set OCI to nil under the fair value approach is not available to assets accounted at fair value through OCI. Setting OCI on the liabilities to nil at transition, whilst maintaining the historical OCI on related assets, will	EFRAG letter to IASB 3/9/2018	Q12.7, Q12.22 and Q12.26

Issue	Description and Implications	References	Related IN Question
	significantly distort equity at transition and results going forward. At its February 2019 meeting, the IASB tentatively decided that no change would be made. The AASB 17 TRG agrees that no change is needed.	CFO Forum October 2018 letter IASB October 2018 meeting – AP2D IASB February 2019 meeting – AP2C	
Transition - Options	Some users are concerned that the availability of the transition options could reduce comparability of the entities' performance going forward, potentially for a number of years. The AASB 17 TRG agrees that no change is needed. At its February 2019 meeting, the IASB tentatively decided that there should be no change in the options available.	IASB October 2018 meeting – AP2D IASB February 2019 meeting – AP2D	Q12.10
Comparative Information	Some users have suggested that the IASB can address the concerns expressed about the effective date by permitting entities not to present adjusted comparative information when applying IFRS 17. They are concerned that financial statements that restate comparative information about insurance contracts, but not about financial assets, could distort users' understanding of those entities' economic circumstances and transactions both in prior periods and the current period. This is because the comparative period might show accounting mismatches between insurance contracts and related financial assets, and the net financial position and profit reported by entities in the comparative period would not be comparable to that reported in the current reporting period. However, comparatives are seen as important, and the proposed implementation delay largely negates this objection. The AASB 17 TRG agrees that no change is needed. At its February 2019 meeting, the IASB tentatively decided that comparative information should be provided on transition.	IASB October 2018 meeting – AP2D IASB February 2019 meeting – AP2B	

Table 4: Areas where the IASB seems to be open to changing the Standard, or has decided that a change should be made

Issue	Description and Implications	References	Related IN Question
Multi-component Contracts	Certain contracts exposing the issuer to credit risk that are in substance loans (for example equity release mortgages in the UK) contain a small insurance element which causes the entire contract to be subject to insurance accounting under IFRS 17. Including these products in the scope of IFRS 17 is inconsistent with the treatment of similar products in other industries. This will also apply to the No Negative Equity Guarantee on Reverse Mortgages in Australia. Also, certain products change significantly in nature during their life due to the execution of an option by the policyholder. (E.g. if a participating contract becomes paid-up without any participation. Yet assessment of which model to use is done at inception.) (Also see earlier comment re investment components and multiple insurance components, for which no change is proposed.) At its February 2019 meeting, the IASB tentatively decided that entities issuing such contracts should have the option to use IFRS 9 or IFRS 17 for the entirety of the contracts. This would enable IFRS 9 to be used where the contract is predominantly a loan or an investment. The AASB 17 TRG supports this change.	AASB TRG July 2018 meeting – AP3 CFO Forum October 2018 letter IASB October 2018 meeting – AP2D IASB February 2019 Meeting – AP2A	Q2.8 – Q2.9 and Q2.31
Deferral of DAC	It is argued that the allocation of all acquisition costs to the first year of a contract is inconsistent with other industries which capitalize acquisition costs over multiple contract periods. This also results in incorrect matching of income and expenses over time. The implications are intensified if the inability to allocate acquisition costs to future periods results in contracts being onerous in accounting (but not in economic reality). At its January 2019 meeting, the IASB tentatively decided that certain acquisition cash flows (i.e. only costs that are directly attributable to the contract - like initial commission) are required to be allocated to both the current contract period and future periods when the	EFRAG letter to IASB 3/9/2018 CFO Forum October 2018 letter IASB October 2018 meeting – AP2D IASB January 2019 meeting – AP2A	Q2.24 – Q2.28

Issue	Description and Implications	References	Related IN Question
	contract is renewed. The acquisition cash flows would be deferred as an asset accordingly. The recoverability of this asset would be assessed at each period, based on the expected fulfilment cash flows of the related group of contracts. A loss would be recognised for any unrecoverable amounts and such losses would be reversed if the impairment conditions no longer exist or have improved. Note that other acquisition costs will still need to be expensed immediately. The AASB 17 TRG supported this change.		
Reinsurance – calculation at inception	There is currently an inability under AASB 17 to recognize profits at inception on reinsurance held covering onerous underlying direct contracts. The implications of this are it: • creates accounting mismatches where none exist in economic terms; • is inconsistent with the principles applied in other IFRS standards; • misrepresents the relationship between the underlying contracts and the corresponding reinsurance/retrocession contracts; and • might affect the ability to use the PAA for the reinsurance business. At its January 2019 meeting, the IASB tentatively decided that a gain should be recognised on initial recognition of a reinsurance contract held (but only those that cover the losses of each contract on a proportionate basis) when the entity recognises losses on onerous underlying insurance contracts. The AASB 17 TRG strongly supports this change.	AALC June 2018 meeting – AP4a) AASB TRG July 2018 meeting - AP01 CFO Forum October 2018 letter IASB October 2018 meeting – AP2D IASB January 2019 meeting – AP2B	Q9.7 to Q9.9
Coverage Units	It was argued that the requirements on coverage units to be used for the CSM amortisation were not appropriate for all types of contracts. A key issue was that the CSM (the initial amount of which is impacted by investment spreads) cannot be amortised over the period in which investment services are provided. For certain contracts, profit recognition is strongly frontloaded or backloaded. (E.g. on a simple	EFRAG letter to IASB 3/9/2018 CFO Forum October 2018 letter	Q6.11

Issue	Description and Implications	References	Related IN Question
	annuity contract profit was not appropriately recognised in the accumulation and deferral phases.) At its January 2019 meeting, the IASB tentatively decided that coverage units should be determined by considering both insurance coverage and any investment return service to the policyholders of the contract (not future policyholders) – and which exists when an insurance contract includes a (non-separated) investment component, and not just when a contract is eligible for the VFA. The relative weighting of the benefits provided by insurance coverage and investment return services and their pattern of delivery is to be made on a systematic and rational basis. It is acknowledged that inclusion of both coverages could change the contract boundary and automatic use of the PAA. The AASB 17 TRG supports this change.	IASB October 2018 meeting – AP2D IASB January 2019 meeting – AP2E	
Transition – Modified Retrospective Approach and Fair Value Approach	The modified retrospective approach is very restrictive and will not provide the simplifications that make retrospective application possible in practice. Insurers will be forced into the fair value approach for many portfolios. Whilst the fair value approach is a helpful practical expedient in some cases, it may not provide an appropriate profit recognition pattern in all cases. Additional approximations (yet to be specified) are therefore needed under the Modified Retrospective Approach. The AASB 17 TRG supports this change. However, at their February 2019 meeting, the IASB tentatively decided that no additional approximations would be provided. In particular, an entity would not be permitted to: • develop its own modifications consistent with the objectives of the MRA; • ordinarily use cash flows that are known to have occurred instead of estimating retrospectively cash flows that were expected to occur; and	EFRAG letter to IASB 3/9/2018 IASB February 2019 meeting – AP2D	Q12.11 - Q12.22

Issue	Description and Implications	References	Related IN Question
	• extend the MRA approximations for business without direct participation features to business with direct participating features. Also at its February 2019 meeting, the IASB tentatively decided to amend the transition requirements that relate to the settlement of claims incurred before an insurance contract was acquired as follows: • to add a specified modification to the modified retrospective approach so that an entity classifies such liabilities as a liability for incurred claims (only where it does not have reasonable and supportable information to apply a retrospective approach); and • to permit an entity applying the fair value approach to choose to classify such liabilities as a liability for incurred claims.		

IAN 100

The IN noted that the International Actuarial Association (IAA) was preparing an International Actuarial Note (IAN) on IFRS 17. The IAA has now released an exposure draft and are seeking comment – see here.

Members of the Australian TF have contributed significantly to the development of the IAN also. Where appropriate in due course, the IN will be adapted to be consistent with the IAN.