Ania

Associazione Nazionale fra le Imprese Assicuratrici

2021 Edition

ANIA Exploring IFRS

Focus on IFRS 17 and IFRS 9

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Newsletter **ANIA**

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*In light of the forthcoming "revolution" of the accounting framework of the insurance sector, brought forward by the adoption of IFRS 17 "Insurance Contracts" principle, ANIA has decided to launch a new series of newsletter: "**ANIA Exploring IFRS**".*

The aim of "ANIA Exploring IFRS" is to provide useful insights on the International Financial Reporting Standards world, with an initial focus on IFRS 17.

The series will then continue by addressing other standards relevant for the insurance industry, such as - but not limited to - IFRS 9 "Financial Instruments" principle.

The newsletters will be issued on a regular basis, in a one-page format, and each issue will focus on specific features of the IFRS principle in question.

The newsletters will be collected in a single volume to form a practical - and easy to use - reference guide.

Angelo Doni
ANIA Co-Director General

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IFRS 17: Endorsement Process

1 MARCH, 31 2021

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Entry-into-force

The entry into force of IFRS 17 "Insurance Contracts" was originally set as of 1 January 2021.

In March 2020, however, the International Accounting Standards Board (IASB) decided to postpone the **effective date** to annual reporting periods beginning on - or after - **1 January 2023**, with the aim of allowing sufficient time for an orderly introduction of the new principle.

In order to **align the dates of implementation of IFRS 9 and IFRS 17**, the IASB decided at the same time to extend the exemption in place for the application of IFRS 9 "Financial Instruments" by insurers.

In June 2020, the IASB issued the amended version of IFRS 17, containing the new effective date of 1 January 2023.

European endorsement process

In order to become applicable in the European Union, **IFRS principles have to be endorsed at European level** following a specific procedure, as set out in Regulation (EC) No 1606/2002 (IAS Regulation).

The endorsement process is carried out by the **European Commission (EC)**, that avails itself of **two advisory organisations**: the European Financial Reporting Advisory Group (**EFRAG**) and the Accounting Regulatory Committee (**ARC**).

The process starts with EFRAG, which is required to render an opinion to the EC on the compliance of the standard with the requirements set forth by EU regulation. The three endorsement criteria to be met are: i) the standard should not be contrary to the true and fair view principle; ii) the standard should be conducive to the European public good; iii) the standard should meet the criteria of understandability, relevance, reliability, and comparability.

After EFRAG has submitted its advice, the EC prepares and presents a draft regulation to ARC, a committee composed of representatives of EU countries and chaired by the EC. The ARC subsequently gives its opinion - voting on the basis of the qualified majority rule - on the endorsement of the standard.

If the ARC's opinion is positive, **the EC submits the draft regulation to the European Parliament** and the **Council** for a three-month scrutiny period. If there are no objections from the European Parliament or the Council, the Commission adopts the endorsing regulation.

The new regulation is then published in the Official Journal of the European Union and enters into force on the day laid down in the regulation itself.

As for IFRS 17, **on 29 March 2021 the EFRAG Board approved its final endorsement advice**.

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IFRS 17: Main objectives

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The new standard for insurance contracts, **IFRS 17**, aims to **increase transparency** and to **reduce differences in the accounting** for insurance contracts. If IFRS 4 allows insurers to use their local accounting standards, IFRS 17 defines rules that will **increase financial statements' comparability**.

The new standard will replace the current IFRS 4 and, therefore, key financial metrics and key performance indicators will change.

Premium volumes will no longer drive the 'top line' in the income statement because investment components (many insurance premiums include an investment, i.e. deposit, component) and cash received can no longer be considered as revenues.

The 'top line' will be driven by **a different way to represent revenues**, and consequently, the new measurement model may result in profits being released over significantly different patterns for some insurance contracts with respect to the current IFRS 4 representation.

The impact that financial risks and investment income have on an insurer's results will be presented separately from insurance performance, with the aim to provide a clearer picture of profit drivers and to give a separate presentation of underwriting and financial results.

In addition, IFRS 17 contains **detailed qualitative and quantitative disclosure requirements**. The objective is to disclose information that - together with information presented in the primary financial statements - provides a basis for users of the financial statements to assess the effects that insurance contracts have on the financial position, the financial performance and the cash flows of the entity.

To achieve this objective, IFRS 17 requires specific disclosures about:

- **Amounts recognized in the financial statements;**
- **Significant judgments made when applying IFRS 17**; and
- **The nature and extent of risks from insurance contracts**.

If these specific disclosures are deemed insufficient, an entity has to disclose additional information necessary to meet the objective.

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IFRS 17: Scope

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In line with **IFRS 4**, an entity applies **IFRS 17** to contracts that meet the insurance contract's definition. **IFRS 17 focuses on types of contracts, rather than types of entities**. Therefore, it applies to all entities, whether they are regulated as insurance entities or not.

An **insurance contract** is "*a contract under which one party - the issuer - accepts 'significant insurance risk' from another party - the policyholder.*" If a *"specified uncertain future event - the insured event - adversely affects the policyholder*", then the policyholder has a right to obtain compensation from the issuer under the contract.

'**Insurance risk**' is a risk, other than financial risk, that is transferred from the policyholder to the issuer of a contract.

Insurance risk is "significant" only if there is a scenario that has commercial substance in which, on a present value basis, there is a possibility that an issuer could:

- suffer a loss caused by the insured event; and
- pay significant additional amounts beyond what would be paid if the insured event had not occurred.

To have commercial substance, it must have a discernible effect on the economics of the transaction. A contract is not an insurance contract if it exposes the issuer only to financial risk but not to significant insurance risk. However, contracts that expose the issuer to both financial risk and significant insurance risk could be insurance contracts.

Reinsurance contracts need to meet the definition of an insurance contract to be in the scope of IFRS 17.

Investment contracts with Discretionary Participation Features (DPF) are in the scope of IFRS 17 if they are issued by an entity that issues also insurance contracts even if they do not transfer significant insurance risk. A DPF contract is a financial instrument that provides an investor with a contractual right to receive, as a supplement to an amount not subject to the discretion of the issuer, additional amounts that are:

- expected to be a significant portion of the total contractual benefits;
- contractually paid at the discretion of the issuer (regarding timing or amount); and
- contractually based on returns from a specified pool of contracts/ assets.

Insurers are subject to the requirements of other applicable standards for products (or components of products) that are not in the scope of IFRS 17.

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IFRS 17: Separating components

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Insurance contracts create a bundle of rights and obligations that work together to generate a package of cash flows.

While some types of **insurance contracts** provide exclusively insurance coverage that falls under IFRS 17, **others** - e.g. unit-linked and other participating contracts - **may contain one or more components.** Were these components separate contracts, they would be **within the scope of other IFRS standards**.

Some insurance contracts may contain:

- ***investment components***: e.g. pure deposits, such as financial instruments whereby an entity receives a specified sum to be repaid with interests;
- ***good and service components***: e.g. services other than insurance contract services, such as pension administration, risk management services, asset management, or custody services;
- ***embedded derivatives***: e.g. financial derivatives, such as interest rate options or options linked to an equity index.

Investment components and goods and services components have to be separated from an insurance contract, **if they are distinct**, and will follow respectively "IFRS 9- Financial Instruments" and "IFRS 15 - Revenue from Contracts with Customers".

Additionally, IFRS 9 is applied to determine when an embedded derivative needs to be separated from the host insurance contract and to be accounted for separately.

If the components are not distinct, then the separation is prohibited under IFRS 17.

As for **good and service components**, they are considered distinct if the insurance contract holds a promise to provide goods or services - other than the insurance contract service - and if the policyholder can benefit from the goods or services either:

- on their own; or
- with other resources that are readily available to the policyholder - i.e. resources that were already obtained or are sold separately by the entity or any other entity.

Goods or services other than insurance contract services are not distinct and are accounted for together with the insurance component, if:

- the cash flows and risks associated with the good or service are highly inter-related with the cash flows and risks of the insurance component; and
- the entity "*provides a significant service of integrating the good or service with the insurance components*".

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IFRS 17: Investment component

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An "*investment component*" **represents the amount an entity has to repay - according to an insurance contract - in all circumstances, even if the insured event does not occur**. These include circumstances in which an insured event occurs, or the contract matures or terminates without an insured event occurring.

If "distinct", an investment component has to be **separated from the insurance contract** and **accounted for according to "IFRS 9- Financial Instruments" requirements**.

The investment component **is distinct if**:

- this component and the insurance component **are not "*highly inter-related*"**; and
- **a contract with equivalent terms is sold or could be sold separately in the same market or same jurisdiction**. An entity takes into account all reasonably available information when it makes this assessment, but it does not have to undertake an exhaustive search.

Investment and insurance components are "*highly inter-related*" if:

- a policyholder cannot benefit from one component without the other being present - e.g. the lapse or maturity of one component causes the lapse or maturity of the other; or
- the entity cannot measure one component without considering the other - e.g. when the value of one component varies according to the other's value.

The separated investment component is accounted for under IFRS 9 unless **it is an investment contract with discretionary participation features in the scope of IFRS 17**.
Investment components that are not distinct from the insurance contract are not separated and **are accounted for together with the insurance component**.

Notwithstanding that, it should be noted that:

- revenue and claims from the non-distinct investment components are excluded from insurance contract revenue and insurance service expenses presented in profit or loss;
- differences between any non-distinct investment component expected to become payable in the period and the actual investment component that becomes payable in the period, measured at the discount rates determined on initial recognition, adjust the Contractual Service Margin of a group of insurance contracts.

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ANIA, the Italian Insurance Association,
founded in 1944, is a voluntary non-profit association.
Its main purpose is to develop and spread the culture of safety
and prevention in our country, so as to protect both people
and companies, and society as a whole, more and better.

Moreover, ANIA represents its members and the Italian insurance market
vis-à-vis the main political and administrative institutions, including the
Government and Parliament,
trade unions and other social bodies.

The Association studies and cooperates in the resolution
of technical, economic, financial, administrative, fiscal, social, juridical and
legislative issues concerning the insurance industry.
It supports and provides technical assistance to members,
promotes the education and professional training of those
working in the insurance sector.

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