PAPER: 03

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Potential implementation question

IFRS 17 requires a fully retrospective approach to be taken for transition calculation unless impracticable. Other than the fact that the classification on portfolio / group / cohort / measurement model etc has to be done on the issue day of every existing contract, the key implication of this requirement is that historical information has to be extracted such that the balances of Contractual Service Margin ("CSM") and Other Comprehensive Income ("OCI") are rolled forward in a proper way.

IFRS17.B134 stipulates that for insurance contracts with direct participation features and for which the entity holds the underlying items, the amount to be included under insurance finance income or expense shall exactly match the income or expenese incluced in profit or loss for the underlying items, resulting in the net of the two separately presented items being nil. The amount to be recognized in OCI for these contracts will therefore depend on the historicial P&L / OCI recognized for asset.

IFRS 9 contains a general requirement that it should be applied retrospectively but the date of initial application will be 1 January 2021. Entities are require to revisit designations previously made in accordance with IAS 39. Difference between the previous reported carrying amounts and new carrying amounts of financial assets and liabilities should be recognised in the opening retained earnings (or other component of equity). Given that this one time adjustment does not go through P&L, this will not be captured in the OCI calculation for liability under IFRS 17. This may then result as a mismatch of cumulative balance of OCI between asset and liability.

Paragraph of HKFRS/IFRS 17 *Insurance Contracts*

89 For insurance contracts with direct participation features, for which the entity holds the underlying items, an entity shall make an accounting policy choice between:
(a) including insurance finance income or expenses for the period in profit or loss; or
(b) disaggregating insurance finance income or expenses for the period to include in profit or loss an amount that eliminates accounting mismatches with income or expenses included in profit or loss on the underlying items held, applying paragraphs B134–B136.

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

C3 An entity shall apply IFRS 17 retrospectively unless impracticable, except that:
(a) an entity is not required to present the quantitative information required by paragraph 28(f) of IAS 8

Accounting Policies, Changes in Accounting Estimates and Errors; and
(b) an entity shall not apply the option in paragraph B115 for periods before the date of initial application of IFRS 17.

Relevant sections in IFRS 9:
7.2.1 An entity shall apply this Standard retrospectively, in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, except as specified in paragraphs 7.2.4–7.2.26 and 7.2.28. This Standard shall not be applied to items that have already been derecognised at the date of initial application.

Analysis of the question

An example is provided below to illustrate the issue:

Facts provided:
- An insurance contract is issued as of 1 Jan 2020 with single premium of 100
- An asset is purchased at 100 which exactly matches all expected cash outflow of the insurance contract
- The classification of the asset is changed from AFS to FVPL upon implementation of IFRS 9 (i.e. 1 Jan 2021). For liability, disaggregation to OCI under IFRS17.89(b) is opted for.
- No experience variance is observed throughout the entire contract except that interest rate drops in 2020, resulting as an increase in fair value of 10 on both asset and liability.

View A:
The retrospective approach stipulated in IFRS 9 does not mean its interaction with IFRS 17 has to be determined retrospectively. The transition calculation for the contract shall follow the asset classification before effective of IFRS 9 (i.e. IAS39).
As of 31 Dec 2020, there is OCI balance for both asset and liability of 10 respectively. The OCI balance for asset will be transferred to equity on 1 Jan 2021 when IFRS 9 is implemented and becomes zero. There is no P&L impact on the effective date and therefore the OCI balance for liability will remain unchanged at 10.

View B:
The retrospective approach stipulated in IFRS 9 means its interaction with IFRS 17 has to be determined retrospectively. The transition calculation for the contract shall follow the asset classification after effective of IFRS 9.
As of 31 Dec 2020, the OCI balance for liability is zero since the amount to be recognized in P&L is the amount required to offset the fair value change for asset of 10. This is exactly equal to the fair value change in liability and no amount is recognized in OCI.

While there is no guidance provided in IFRS 17 to handle the interaction with IFRS 9 during transition, we believe View B is appropriate as the resulting cumulative OCI balance will more accurately reflect the relationship between asset and liability.