IFRS 17 - Transition

Introduction

IFRS 17 applies to entities for annual reporting periods on or after 1 January 2021 (though earlier application is permitted) with an implied transition date of 1 January 2020 for companies with a 31st December year-end. Entities will need to calculate a contractual service margin (CSM) or loss component (LC) for each group of insurance contracts as at this date, based on one of the three transition approaches as set out in Appendix C of the IFRS 17 Standard. This Working Party will refer to these approaches as:

- ‘Fully retrospective approach’
- ‘Modified retrospective approach’
- ‘Fair value approach’

In the context of transition, this Working Party has been tasked with examining and discussing issues that relate to the determination of the CSM/LC under these three transition approaches.

What are the transition requirements?

IFRS 17 requires that entities apply the Standard retrospectively (i.e. apply the measurement requirements to groups of insurance contracts as if IFRS 17 had always applied) unless it is *‘impracticable’* for the entity to do so (as defined by IAS 8 “Accounting Policies, Changes in Accounting Estimates and Changes in Accounting Policies”). This is referred to as the ‘fully retrospective approach’.

If an entity has established that the fully retrospective approach is impracticable for a particular group of insurance contracts; what options does it then have for transition?

Paragraph BC378 highlights that the IASB recognized that the measurement of several types of items needed for the fully retrospective approach would often be impracticable. Consequently, the modified retrospective approach and the fair value approach were developed as a response.

Modified retrospective approach vs fair value approach

The modified retrospective approach offers a number of specific permitted modifications to the fully retrospective approach in various areas of the standard, generally to address areas where hindsight might otherwise be required. For general model business there are a range of permitted modifications - to be used only where these are required - whereas for business under the variable fee approach, a more prescribed modified approach is set out.

Under the fair value approach, the CSM is calculated as the difference between the fair value of the liabilities (per IFRS 13) and the fulfilment cash flows as at the transition date.

An important aspect of the IFRS 17 requirements for transition is that the Standard does not establish a ‘pecking order’ between the modified retrospective approach and the fair value approach. If the fully retrospective approach is impracticable to apply, entities have a free choice in applying either the modified retrospective approach (where they are able to) or the fair value approach for transition. This therefore allows scope for companies to explore the cost and benefits of either approach and seek to optimise their CSM (and therefore balance sheet position) on transition accordingly.

What will future articles cover?

Future articles will consider a range of issues for transition for each of the three retrospective approaches. Examples of areas that will be investigated include:

- Practical issues in carrying out or auditing the calculations under each approach

- Technical issues specific to each transition approach
- Uncertainty in the measurement of fair value under IFRS 13
- Product-specific issues relating to transition under IFRS 17

On behalf of the IFoA IFRS 17 CSM Working Party

Rebecca Sardar - Chair

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