

## IFRS 17 Accounting Policy Paper: Transition

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<b>Approvers / Reviewers:</b>	Approved by: FA Accounting Committee
<b>Subject:</b>	Transition

### **Disclaimer:**

This accounting policy paper, which is the responsibility of the Facility Association's (FA) management, is prepared solely for the FA as administrator of certain insurance pools, namely the Facility Association Residual Market (FARM) and each of the Risk Sharing Pools (RSPs). It is intended solely for the use of the FA to document management's accounting policy determinations under IFRS 17 as part of management's internal financial reporting and governance processes as applicable to the FARM and each of the RSPs.

This accounting policy paper is being made available through the FA website to member insurance companies for general information purposes only and does not constitute advice from the Facility Association. Member insurance companies are responsible for their own assessment of IFRS 17 as applicable to their financial reporting. We disclaim any responsibility to any member insurance company who may rely on this document.

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## **Purpose**

The purpose of this paper is to document Facility Association's interpretation of the requirements of IFRS 17 relating to the transition approaches and the application of those requirements to insurance contracts issued by servicing carriers through the Facility Association Residual Market ("FARM") and to insurance contracts ceded by individual member companies through the Risk Sharing Pools ("RSPs") to the collective members. This paper presents Facility Association's assessment of whether the full retrospective calculations are appropriate for each mechanism.

## **Entities:**

Facility Association (FA) administers three types of mechanisms on behalf of its membership. This paper covers only the two mechanisms in the scope of IFRS 17, namely:

- Facility Association Residual Market ("FARM")
- Risk Sharing Pools ("RSPs")\*

\* Outside the scope of this paper are requirements relating to the direct business issued by the individual members prior to ceding the business to the RSPs. Only business assumed via each of the six RSPs will be addressed in this memo.

## **Topics Covered**

The topics covered in this paper are as follows:

1. What is the transition date and what is the date of initial application?
2. Which comparative period should be shown?
3. What method of transition are FARM and RSPs eligible to apply?

## **Dependencies and Relationships**

The technical positions developed in this paper are subject to the conclusions of the following papers:

1. Scope
2. Level of Aggregation
3. Initial recognition and contract boundary
4. Initial and subsequent measurement
5. Insurance acquisition cash flows
6. Risk adjustment
7. Discount rate
8. Modification and extinguishment of insurance contract

## Executive summary

IFRS 17 identifies three approaches for transition to IFRS 17 from IFRS 4: the full retrospective approach, the modified retrospective approach and the fair value approach. The standard requires the full retrospective approach on the date of transition, unless it is impracticable to implement, in which case the entity has the option to apply the modified retrospective approach or the fair value approach.

The purpose of this paper is to determine the appropriate transition method for FARM and RSPs under IFRS 17. Facility Association has decided to early adopt IFRS 17 as well as IFRS 9 for both FARM and RSPs (please refer to IFRS 9 accounting policy paper). As the mechanisms are not under any requirements from the Office of the Superintendent of Financial Institutions (OSFI) or any provincial regulators, that would preclude the FARM and RSPs from early adopting IFRS 9 and 17, this is allowed for both mechanisms. As such, the below paper proposes the first annual reporting period in which FARM and RSP will apply IFRS 9 and 17 to be November 1, 2022 to October 31, 2023 with comparative information presented for November 1, 2021 to October 31, 2022 and an opening statement of financial position as of November 1, 2021. All insurance liabilities are required to be measured under IFRS 17 and recorded in the financial statements for the year ended October 31, 2023 (with comparative for the year ended October 31, 2022), with all required disclosures in the notes to financial statements to comply with IFRS 9 and 17 disclosure requirements, and any differences from IFRS 4 will be recorded in the opening balance of the amount due from /to members of 2021.

FA reached the following conclusions regarding the transition requirements under IFRS 17 related to insurance contracts issued by servicing carriers through the FARM and to insurance contracts ceded by individual member companies through the RSPs to the collective members:

- 1- What is the transition date and what is the date of initial application?
  - a. For the purpose of preparing the financial statements of the FARM and RSPs, the transition date for adoption of IFRS 17 will be November 1, 2021 and the date of initial application will be November 1, 2022.
    - i. Transition date: November 1, 2021
    - ii. Comparative period: November 1, 2021 – October 31, 2022
    - iii. Date of initial application: November 1, 2022 – October 31, 2023
- 2- Which comparative period should be shown?
  - a. The disclosures will be presented for the comparative period from November 1, 2021 to October 31, 2022.
  - b. In addition, a third statement of financial position will be included for the opening balances as at November 1, 2021.
- 3- What method of transition are FARM and RSPs eligible to apply?
  - a. The full retrospective approach will be used for both FARM and RSPs.

**Question 1: What is the transition date and what is the date of initial application?*****Technical References and Guidance*****IFRS 17 Standard**

C1 An entity shall apply IFRS 17 for annual reporting periods beginning on or after 1 January 2023. If an entity applies IFRS 17 earlier, it shall disclose that fact. Early application is permitted for entities that apply IFRS 9 Financial Instruments on or before the date of initial application of IFRS 17.

**Technical Analysis:**

IFRS 17 is required to be applied for annual reporting periods beginning on or after January 1, 2023. However, early adoption of IFRS 17 along with IFRS 9 has been elected by both FARM and RSPs and therefore, they will adopt IFRS 17 along with IFRS 9 with the initial application date of November 1, 2022<sup>1</sup>.

**Date of initial application: November 1, 2022**

**Technical position:**

Mechanism	Technical Position
FARM	Date of initial application will be November 1, 2022
RSP	

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<sup>1</sup> The initial application date presented above is for the purpose of preparing the financial statements of FARM and RSPs, the information under IFRS 17 will be made available to members for the period beginning January 1, 2023.

## Question 2: Which comparative period should be shown?

### *Technical References and Guidance*

#### **IFRS 17 Standard**

- C2 For the purposes of the transition requirements in paragraphs C1 and C3–C33:
- (a) the date of initial application is the beginning of the annual reporting period in which an entity first applies IFRS 17; and
  - (b) the transition date is the beginning of the annual reporting period immediately preceding the date of initial application.

#### **IAS 1 Presentation of financial statements**

40A An entity shall present a third statement of financial position as at the beginning of the preceding period in addition to the minimum comparative financial statements required in paragraph 38A if:

- (a) it applies an accounting policy retrospectively, makes a retrospective restatement of items in its financial statements or reclassifies items in its financial statements; and
- (b) the retrospective application, retrospective restatement or the reclassification has a material effect on the information in the statement of financial position at the beginning of the preceding period.

### **Technical Analysis:**

Upon transition, there is a requirement to present the opening balances as well as comparative information for the annual reporting period prior to the date of application of IFRS 17. In addition, as per IAS1.10(f) a complete set of financial statements comprise *a statement of financial position as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements in accordance with paragraphs 40A–40D.*

Because the changes in accounting policies arising from IFRS 17 will have a material effect on the information in the statements of FARM and RSPs, a third statement of financial position as at the transition date is expected to be presented.

As such, the transition date is November 1, 2021<sup>2</sup>. The first complete set of IFRS 17 financial statements will be as at and for the year ended October 31, 2023, with a comparative period ended October 31, 2022 as required per IFRS 17. This is summarized below:

- Transition date (opening balances): November 1, 2021
- Comparative period: November 1, 2021 – October 31, 2022
- Period of first IFRS 17 FS: November 1, 2022 – October 31, 2023

<sup>2</sup> The comparative information period presented above is for the purpose of the financial statements of the FARM and RSP, the financial information for the transition period beginning January 1, 2022 will be made available to members.

**The comparative period will be the year ended October 31, 2022 including opening statement of financial position as at November 1, 2021**

**Technical position:**

Mechanism	Technical Position
FARM	The financial statements for comparative year-ended October 31, 2022 will be presented and a third statement of financial position will be presented for the opening balances as at November 1, 2021.
RSP	

### Question 3: What method of transition are FARM and RSPs eligible to apply?

#### *Technical References and Guidance*

#### **IFRS 17 Standard**

- C3 Unless it is impracticable to do so, or paragraph C5A applies, an entity shall apply IFRS 17 retrospectively, 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 transition date. An entity may apply the option in paragraph B115 prospectively on or after the transition date if, and only if, the entity designates risk mitigation relationships at or before the date it applies the option.
- C4 To apply IFRS 17 retrospectively, an entity shall at the transition date:
- (a) identify, recognise and measure each group of insurance contracts as if IFRS 17 had always applied;
  - (aa) identify, recognise and measure any assets for insurance acquisition cash flows as if IFRS 17 had always applied (except that an entity is not required to apply the recoverability assessment in paragraph 28E before the transition date);
  - (b) derecognise any existing balances that would not exist had IFRS 17 always applied; and
  - (c) recognise any resulting net difference in equity.
- C5 If, and only if, it is impracticable for an entity to apply paragraph C3 for a group of insurance contracts, an entity shall apply the following approaches instead of applying paragraph C4(a):
- (a) the modified retrospective approach in paragraphs C6–C19AC19, subject to paragraph C6(a); or
  - (b) the fair value approach in paragraphs C20–C24BC24.
- C5A Notwithstanding paragraph C5, an entity may choose to apply the fair value approach in paragraphs C20–C24B for a group of insurance contracts with direct participation features to which it could apply IFRS 17 retrospectively if, and only if:
- (a) the entity chooses to apply the risk mitigation option in paragraph B115 to the group of insurance contracts prospectively from the transition date; and
  - (b) the entity has used derivatives, non-derivative financial instruments measured at fair value through profit or loss, or reinsurance contracts held to mitigate financial risk arising from the group of insurance contracts, as specified in paragraph B115, before the transition date.
- C5B If, and only if, it is impracticable for an entity to apply paragraph C4(aa) for an asset for insurance acquisition cash flows, the entity shall apply the following approaches to measure the asset for insurance acquisition cash flows:



- (a) the modified retrospective approach in paragraphs C14B–C14D and C17A, subject to paragraph C6(a); or
- (b) the fair value approach in paragraphs C24A–C24B.

## IAS 8 Standard

- 23 When retrospective application is required by paragraph 19(a) or (b), a change in accounting policy shall be applied retrospectively except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change.
- 24 When it is impracticable to determine the period-specific effects of changing an accounting policy on comparative information for one or more prior periods presented, the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period.
- 25 When it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the entity shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable.
- 50 In some circumstances, it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy (including, for the purpose of paragraphs 51–53, its prospective application to prior periods) or retrospective restatement to correct a prior period error, and it may be impracticable to recreate the information.
- 51 It is frequently necessary to make estimates in applying an accounting policy to elements of financial statements recognised or disclosed in respect of transactions, other events or conditions. Estimation is inherently subjective, and estimates may be developed after the reporting period. Developing estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error, because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of estimates related to prior periods remains the same as for estimates made in the current period, namely, for the estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.
- 52 Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that
- (a) provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and
  - (b) would have been available when the financial statements for that prior period were authorised for issue from other information. For some types of estimates (eg a fair value measurement that uses significant unobservable inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these

two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.

- 53 Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in calculating its liability for employees' accumulated sick leave in accordance with IAS 19 Employee Benefits, it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior period were authorised for issue. The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

### **Technical Analysis:**

There are three transition approaches under IFRS 17: the full retrospective approach, the modified retrospective approach and the fair value approach. Entities are required to apply IFRS 17 retrospectively (i.e. using the full retrospective approach) unless it is impracticable to do so, in which case entities may apply either of the other two approaches. The transition guidance is applied to groups of insurance contracts as determined in FA's ***Level of Aggregation*** accounting policy paper. This means that it is possible for a single entity to apply different transition approaches, if applicable, for specific groups of insurance contracts.

The full retrospective approach involves determining the assets and liabilities relating to insurance contracts as if IFRS 17 had always applied and de-recognizing any balances that would not exist had IFRS 17 always applied. Under this approach, any resulting difference in assets and liabilities would be booked to net equity on the transition date.

The modified retrospective approach is a variation of the full retrospective approach, allowing the use of certain permitted simplifications. In comparison, the fair value approach is a distinct alternative that determines the contractual service margin ("CSM") at the transition date in relation to the fair value of the insurance contracts at that time rather than the amount that would be reported on the insurer's statement of financial position at the transition date had they always reported under IFRS 17.

As determined in FA's ***Initial and Subsequent Measurement*** accounting policy paper, all insurance contracts issued via the FARM and all insurance contracts assumed through the RSPs will be measured under the Premium Allocation Approach (PAA). Considering that neither the FARM nor the RSPs will use the General Measurement Model ("GMM") when implementing IFRS 17, there will not be a requirement to determine the CSM.

As per IAS8.5, full retrospective application is impracticable when *the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:*

- (a) *the effects of the retrospective application or retrospective restatement are not determinable;*
- (b) *the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or*
- (c) *the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:*

- (i) *provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and*
- (ii) *would have been available when the financial statements for that prior period were authorised for issue from other information.*

From a practical standpoint, retrospective application of IFRS 17 would be impracticable if the insurer does not have the required data, if it must use hindsight to apply the standard or if it must make determinations that needed to be made in the past.

Application of the full retrospective approach poses a lesser challenge for contracts accounted for under the PAA because these contracts usually have relatively short coverage periods, and the challenges around determining the CSM do not arise.

As shown in FA's ***Initial and Subsequent Measurement*** accounting policy paper, all insurance contracts issued via the FARM and all insurance contracts assumed through the RSPs have contract boundary of 12 months. As a result, in order to disclose the comparative information in the financial statements presented under IFRS 17, information is only required from November 1, 2021. FA has determined that this historical information is readily available given the short timeframe, which will allow for the full retrospective method to be used for FARM and the RSPs.

In order to apply IFRS 17 to insurance contracts using the full retrospective approach, the following considerations will have to be made.

For profitable contracts and onerous contracts, the LRC is needed at the date of transition. For profitable contracts, this will be the amount recognized at initial recognition, adjusted for subsequent measurement. For onerous contracts, this will be the total fulfilment cash flows – and the difference between the total fulfilment cash flows and the LRC recognized at initial recognition under the PAA methodology will be calculated and adjusted for subsequent measurement. Based on findings from the data and reporting workstream, despite changes to existing calculation methodologies and new components of measurement, no new data points or assumptions were identified. Therefore, full retrospective application is required.

It is expected that reasonable and supportable information (i.e. budget and pricing information) will be available for both FARM and the RSPs to determine whether any onerous contracts existed for contracts written in FY2020. As such, there will be no impracticability challenges in applying the full retrospective approach. The fulfilment cash flows and level of aggregation policy decisions have been determined at the time of writing this paper and these data points are available since the beginning of 2021. Furthermore, the calculation of loss component is based on current assumptions as at the date of the transition and would not require historical information or the use of hindsight.

In considering the LIC, the measurement of future cash flows (probability weighted best estimate of the present value of expected cash flows) in IFRS 17 is prospective. Therefore, the measurement of future cash flows at the transition date for contracts recognized before that date is a relatively straightforward application of IFRS 17. To measure the future cash flows in order to determine the LIC, forecasted settlement of incurred claims will be needed, including forecasts for claim/case reserves or IBNR. The information required to determine fulfilment cash flows will be readily available upon transition to IFRS 17. LIC is forward-looking and therefore, no transition requirements specific to the LIC exist.

The risk adjustment is a current assumption applied to the LIC at the date of the transition to reflect the compensation

that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk. The risk adjustment is prospective in nature and impracticability challenges are not expected in applying the full retrospective approach of IFRS 17.

Lastly, because FARM and the RSPs are not taking the OCI option – there are no considerations relevant to determining the amount of accumulated OCI as at the transition date. The contracts are measured using the PAA and all data and assumptions required to recalculate the financial results as though IFRS 17 had always been in effect are expected to be available for RSP and FARM, therefore, full retrospective application is practicable.

**The full retrospective method will be used**

**Technical position:**

Mechanism	Technical Position
FARM	It is practicable for both the FARM and the RSPs to apply the full retrospective approach. Any differences in balances in assets and liabilities upon transition to IFRS 17 from IFRS 4 will be captured in amount due from /to members.
RSP	