



Meeting Summary
Hong Kong Insurance Implementation Support Group (HKIISG)
14 December 2018

Attendance

HKICPA representatives

Shelley So, Chair, Financial Reporting Standards Committee (FRSC)
Christina Ng, Director, Standard Setting
Kam Leung, Associate Director, Standard Setting

HKIISG members

Sai-Cheong Foong, AIA Group Limited
Anthony Lam (representing Kevin Lee), AXA China Region Insurance Company Limited
Ronnie Ng, China Overseas Insurance Limited
Kevin Wong, FWD Life Insurance Company (Bermuda) Limited
Alexander Wong, Hang Seng Insurance
Kenneth Dai, Manulife Asia
Wenhao Zhao (representing Candy Ding), Ping An Insurance (Group)
Devadeep Gupta (representing Nigel Knowles), Prudential Hong Kong Limited
Joyce Lau, Target Insurance Company, Limited
Lal Manglani (representing Francesco Nagari), Deloitte Hong Kong
Doru Pantea, EY Hong Kong
Erik Bleekrode, KPMG China
Chris Hancorn, PwC Hong Kong

Discussion objectives:

Readers are reminded that the objective of the HKIISG is not to form a group consensus or decision on how to apply the requirements of HKFRS/IFRS 17 *Insurance Contracts*. The purpose of HKIISG is to share views on questions raised by stakeholders on the implementation of HKFRS 17. Refer to HKIISG [terms of reference](#).

The meeting summaries of HKIISG discussions are solely to provide a forum for stakeholders to follow the discussion of questions raised. Stakeholders may reference HKIISG member views when considering their own implementation questions—but should note that the meeting summaries do not form any interpretation or guidance of HKFRS 17.

1. [Paper 2](#): Employee Compensation Insurance Residual Scheme (Scheme)

Ms. Joyce Lau presented Paper 2 on the Employee Compensation Residual Scheme (Scheme) which enables employers who have been unable to obtain Employees' Compensation Insurance to obtain such insurance. Employers are required to take out such insurance under Hong Kong law.

Paper 2 introduces the Scheme as a co-insurance scheme whereby the Scheme's Appointed Service Provider (also a participant of the Scheme) issues a co-insurance policy on behalf of its participants (insurers that write Employee Compensation insurance). The participants each record the underwriting result allocated to them (based on their respective market share) as direct business on their respective books. Paper 2 also notes that the Scheme is not a joint venture or jointly controlled operation under IFRS 11 *Joint Arrangements*. For more information on the rights, obligations and operations of the Scheme as discussed at the meeting, refer to pages 5-6.

The questions in Paper 2 are:

- 1) Is the Scheme similar to Pool 1 in the September 2018 IASB TRG meeting paper [AP09](#)?
- 2) What risk adjustment should be applied to such Schemes from the individual insurers' perspective?

The view presented in Paper 2 is that the Scheme is similar to Pool 1, and that the

individual insurers can determine their own risk adjustment for the Scheme (which is consistent with current practice today).

Is the Scheme similar to Pool 1 of the [IASB TRG September 2018 meeting paper AP09](#)?

- A few members noted that page 12, paragraph B4(b) in TRG meeting paper [AP09](#) should be referenced. In particular, they noted that the Scheme does not exactly mirror the fact pattern in Appendix B of AP09 considering paragraph B4(b).
- For example: If a participant in the Scheme becomes insolvent after the policy is issued and the remaining participants in the Scheme are not required to fulfill that insolvent participants' obligations; then it appears that the Scheme will not fit into the fact pattern of AP09 paragraph B4(b)—implying that the Scheme is not similar to Pool 1.

Should the Risk Adjustment (RA) be determined individually or collectively?

- Some insurers argued that there is no need to use a single collective risk adjustment, meaning that they can form their own individual risk adjustment and group the Scheme's policy with their other insurance contracts in their individual books (i.e. the individual participant's book). This is also current practice.
- Other insurers commented that since the Scheme's policy is issued on behalf of all participants, a single collective risk adjustment should then be used by all participants, meaning that the Scheme's policy will be a separate group from other insurance contracts in the individual participants' books. This would change current practice.
- One member noted that at the IASB TRG September 2018 meeting, the IASB staff expressed the view that the RA has to be determined collectively if the insurance policy is collectively issued by all participating insurers. As a result, this member thinks that unless each insurer has the ability to price, it cannot have a different RA for each participating insurer.
- One member noted that even if it is clear that the RA should be determined collectively for an insurance policy which is collectively issued, in practice, it is not clear how to arrive at that single RA.
- One member referred to page 8, paragraph 24(b) in TRG meeting paper [AP09](#), and emphasized that one of the key analyses of what risk adjustment the Scheme should use, is whether the co-insurance policy is issued jointly by all participating insurers. In this respect:
 - One member expressed the view that co-insurance (such as the Scheme) means each insurer is the issuer of the contract separately, and hence each should have a separate RA. However, this member questioned how consistency should be achieved if each insurer has a different RA.
 - One member views the Scheme to be unique because it is managed differently and separately from other Property and Casualty business. Therefore, this member thinks that there is an argument that the Scheme needs its own RA for each participating insurer, even if it is grouped with other PC business. However, this member also questioned whether it would be acceptable that each participating insurer has a different RA for a single co-insurance policy, and thinks that it would be hard to justify how each individual insurer can determine the RA individually.
- One member noted that the conclusion on how to determine the risk adjustment on page 13, paragraph 36 of the [IASB TRG September 2018 meeting summary](#) is unclear.

Other considerations, for example, is the Scheme a reinsurance arrangement?

- A few members questioned if, in substance, the Scheme is a reinsurance arrangement. That is, all participating members who join in the Scheme are reinsurers because all members have only limited risk in the case of insolvency.
- One member responded that there is no reinsurance relationship between the Scheme and its participating insurers. The insurance policy issued by the ASP is a direct contract between policyholder and all participating insurers.
- One member emphasized the importance of reviewing the current contract for its legal

contractual obligations and rights, and performing accounting analysis on it. For example, is the Scheme and its participating insurers a reinsurance arrangement? This member also advised that the Scheme should engage an advisor or consultant as soon as possible.

Action/Conclusion:

HKIISG noted that the terms and conditions of the Scheme provided for the meeting discussion were not sufficient for a detailed assessment to arrive at a conclusion at the meeting.

Nevertheless, the submitter concluded that the discussion by HKIISG has been useful and therefore there is no need to bring this issue back to HKIISG for discussion. The submitter noted that next steps would be taken by the Scheme, including the engagement of an advisor/consultant.

Staff observe from the meeting discussion that it appears there was a strong view that a single collective risk adjustment should be used by all participants in the Scheme, unless other terms and conditions support otherwise.

2. [Paper 3](#): Contract Boundary

Paper 3 was presented which discusses whether the short termination clauses (for example, 7 days or 30 days) contained in many general insurance contracts in Hong Kong will create multiple short contract boundaries under IFRS 17.

Members disagreed with the view held in paragraph 8 of Paper 3. This is because accounting is supposed to reflect the substantive rights and obligations of an entity. Members referred to paragraph 2 of IFRS 17.

Members noted that such termination clauses are also common globally, and observed that when applying IFRS 17 requirements to these contracts, it is quite clear that the termination clauses (refer to extracts in [Appendix A](#)) will create a contract boundary.

Nevertheless, members noted that there will be many other implications to the business as a result of the creation of a short contract boundary. Comments expressed include:

- the premium received upfront will need to be allocated into the portion that relates to the contract boundary (included in the fulfillment cash flows) and the portion that is outside the contract boundary (included as a deposit).
- the right to terminate/cancel the contract can be exercised by policyholder or insurer. If the policy is cancelled by the insurer, then the insurer can only retain an amount of premium that is proportionate to the number of days that the policy was in effect. However, if the policy was cancelled by policyholder, then typically, the insurer can retain a larger portion of the premium. As a result, there is a question what assumption should be used for the allocation of premium to the contract boundary—that is, should the assumption be based on the policyholder or insurer cancelling the policy?
- if the insurer removes its right to cancel in the contract, then the contract boundary could be lengthened. On the other hand, there is a business need for entities to have the right to cancel, for example, in order for them to respond to uncontrollable changes in risk.
- insurers will need to consider how to tackle the creation of multiple contract boundaries in their system.
- the allocation of expenses would also need to be considered. If commission was paid out upfront (with no recourse) at the beginning of the contract, then the first month would be loss making due to recognition of the commission, whilst the second month would be profitable. This may lead to a large volatility in the profit and loss. that the result would depend on whether there is the ability to claw back the commission paid to the agent. If so, then the commission does not need to be fully recognized at the beginning of the contract – a portion of it can be recognized as prepayment instead.

- It would be challenging to account for a rolling series of short contract boundaries whereby each contract will have a:
 - cash inflow – premiums
 - cash outflow – premiums to be refunded (assuming termination clause is exercised) as well as the benefits the insurer needs to pay to the policyholder.

Other members expressed the view that having multiple short contract boundaries may not actually cause many operational difficulties in practice, because:

- The contracts will likely end up being eligible for the Premium Allocation Approach, which will not be as operationally complex.
- The termination/cancellation clauses should be assessed for commercial substance. That is, if the clauses have no commercial substance, then there is no boundary.
- Applying the general model, if there are multiple short contract boundaries, all contracts will likely end up in the same group. Therefore, accounting for a single group may not be as arduous as expected.

Members also discussed the application of paragraph 34 of IFRS 17. In particular, when can the entity compel the policyholder to pay the premiums?

- One member questioned when "the entity can compel the policyholder to pay the premiums" of IFRS 17 paragraph 34 is relevant and asked for an example. Other members responded that all the contractual obligations need to be assessed, and that ultimately, what the insurer can compel the policyholder to do is based on the legal responsibility and duty of the insurer and policyholder.

Action/Conclusion:

Education on this topic should be arranged by HKICPA for the industry. The business and financial implications of having multiple short contract boundaries will be discussed by the staff with the Institute's Insurance Regulatory Advisory Panel to determine the next steps.

3. [Paper 4](#): Staff update and questions for HKIISG

Staff provided HKIISG members with an update on:

- a) A letter from Hong Kong Federation of Insurers to the IASB requesting deferral of the effective date of IFRS 17;
- b) Year-end Reflections of HKIISG and next steps;
- c) HKIISG's proposed 2019 meeting schedule;
- d) The paper the HKICPA sent to IASB staff covering the top technical issues in the Hong Kong insurance industry;
- e) IASB developments; and
- f) Other matters.

Mr. Sai-Cheong Foong volunteered to submit a paper for discussion on coverage units for multiple risks. Mr. Lal Manglani (representing Francesco Nagari) expressed interest on the topics of coverage units and reinsurance, whether it be to submit a paper for discussion or to provide input on educational materials.

Suggestions on training and how to encourage general insurers to accelerate implementation actions were discussed. In addition, suggested interactions with the Hong Kong Insurance Authority (IA) and the Hong Kong Federation of Insurers (HKFI) were raised by a few HKIISG members, for example: (i) education on the consequences of not implementing IFRS 17 on time as well as benefits of implementing; (ii) similar to actions by the Korean regulator, to request IA to conduct more implementation status checks on companies and for HKICPA to provide HKFI with a standardized accounting for products issued by smaller insurers. Staff responded that HKICPA's policy prohibits it from specifying the accounting for individual products. Companies have the responsibility to form its own view on the accounting of specific products against the principle-based

standard. HKICPA could liaise with HKFI to submit issues or questions on the accounting by smaller insurers for discussion at HKIISG. In terms of implementation status checks, it is up to the IA to monitor implementation as they consider appropriate. Nevertheless, the model of the Korean regulator can be raised and explored with the IA.

HKIISG's proposed 2019 meeting schedule was agreed upon. *[Post-meeting note: the latest updated schedule has been published [online](#).]*

Members noted the latest IASB developments, including the IASB October Board meeting which identified 25 issues to be discussed at upcoming Board meetings and the proposed deferral of IFRS 17 by one year. In particular, members commented that the additional one year, if IFRS 17 were to be delayed as proposed, would be useful most notably for better system development and testing and better planning of communications to stakeholders. However, it is unlikely that the industry could afford to slow down or defer implementation by more than one year. Staff noted that potential amendments will likely arise from these 25 issues, however any amendments are not expected to change the fundamentals of IFRS 17. Staff commented that delays in implementation are not acceptable reasons for delaying HKFRS 17.

The status of software vendor selection and systems design in the industry was discussed. It was noted that whilst some members have selected their vendors, they are still in the early stages of system developments. Other members noted that they are in the process of short-listing the vendors and performing proof of concepts. One member commented that it was challenging to develop a suitable system to calculate the CSM, even though the vendor was selected.

Members noted that representatives from PwC, AIA and HKICPA presented at the Asian Forum of Insurance Regulators (AFIR). The AFIR brings together representatives from insurance regulators across Asia. These representatives presented a:

- Summary of IFRS 17 principles and developments to date
- Perspectives from life and general insurers on the implementation process to date
- Perspectives from HKICPA as Hong Kong's standard setter

The representatives noted that the insurance regulators appeared to be very interested in the implementation process and also how IFRS 17 would interact with the new capital requirements being developed in Hong Kong. They also noted that the AFIR had a closed session with only AFIR members to discuss the IFRS 17 implementation status in their respective jurisdictions.

Action/Conclusion:

Staff will liaise with AIA and Deloitte regarding the topics of coverage units and reinsurance.

ADDITIONAL INFORMATION ON PAPER 2

Background to the Scheme extracted from: <http://www.ecirsb.com.hk/en/about.html#a>

- Under the Hong Kong Employees' Compensation Ordinance, all employers are required to take out insurance policies to cover their liabilities both under the Ordinance and at common law for injuries at work in respect of all their employees.
- The Scheme was incorporated under the Hong Kong Companies Ordinance on 11 April 2007 for the purpose of enabling employers, particularly those engaged in occupations of the High Risk Groups and who have been unable to obtain Employees' Compensation Insurance to obtain such insurance.
- A Board consisting of fifteen employees' compensation insurers has been formed to oversee the direction and execution of the Scheme.
- The Hong Kong Federation of Insurers has been appointed as the Administrator to conduct daily operations while an Underwriting Committee sets the underwriting guidelines and procedures and the Claims Committee sets the parameters for handling claims.

- In addition, an Advisory Committee consisting of Members from the employers, employees, accounting, legal and insurance sectors as well as representatives from the Labour Department and the Insurance Authority has been established to monitor the scheme.
- Finally, an Appointed Service Provider (ASP) has also been appointed to issue policies on behalf of all insurers to Qualifying Employers and handle and pay claims.
- Refer to the rights, obligations and operations of the Scheme as discussed below.

Additional information on the rights, obligations and operations of the Scheme provided by a few HKIISG members at the meeting

- There are 50+ insurers who participate in the Scheme. In practice, all insurers who write employee compensation participate in the Scheme, as encouraged by the Insurance Authority.
- The Scheme operates based on an agreement, which is signed by each participating insurer.
- Since the Scheme is not an authorized insurer, the ASP needs to issue the policy on behalf of all the participating insurers. The ASP is also an authorized insurer, and is allocated its share of underwriting result in the Scheme. Therefore, ASP also takes on its share of risk and needs to maintain capital.
- The policy issued by the ASP on behalf of all participants clearly states each insurer's share of the policy. Therefore, the policyholder is advised and understands that each insurer is only responsible for its own share of the policy.
- Accordingly, each participant is only responsible for its own share of liabilities. However, the Scheme has no right to force participants to pay out claims.
- The Scheme provides reserving suggestions for its participating insurers and will also do a review of reserving. This is intended to help the smaller participating insurers which are outside the scope of [GL 9 issued by the Insurance Authority](#). However, participants have no obligation to follow the Scheme's reserving suggestions.
- If one of the participants goes bankrupt, the other participants are not responsible for that participant's liabilities.
- The Scheme has three funds:
 - Administrative Account – Collects annual membership fees from participating insurers to pay for the services provided by the ASP;
 - Settlement Account – Collects all premiums and settles claims from/to policyholders, as well as paying a service fee to the ASP. If the settlement account is insufficient to pay claims, then the ASP sends out a cash call to collect the amount required;
 - Cash Flow Account – Collects a deposit from each participating insurer, based on its respective market share. If a participating insurer is unable to pay its claims through its settlement account, then the Scheme's Board has the right to pay the claim out of this Cash Flow Account.
- If one of the participants does not pay out its claim, then the policyholder has to chase after that specific participant. In practice, it is noted that the ASP will pay out the claim from the Scheme's funds if possible.
- If one of the participants goes insolvent, the other participants do not have to pay the insolvent participants claims. If the Scheme, under that insolvent participant's settlement and/or cash flow accounts, cannot settle the policyholder claim, then the claim will be passed on to the [Employee Compensation Insurer Insolvency Bureau](#)¹.

¹ The [Employees Compensation Assistance Fund](#) prior to 1 April 2004