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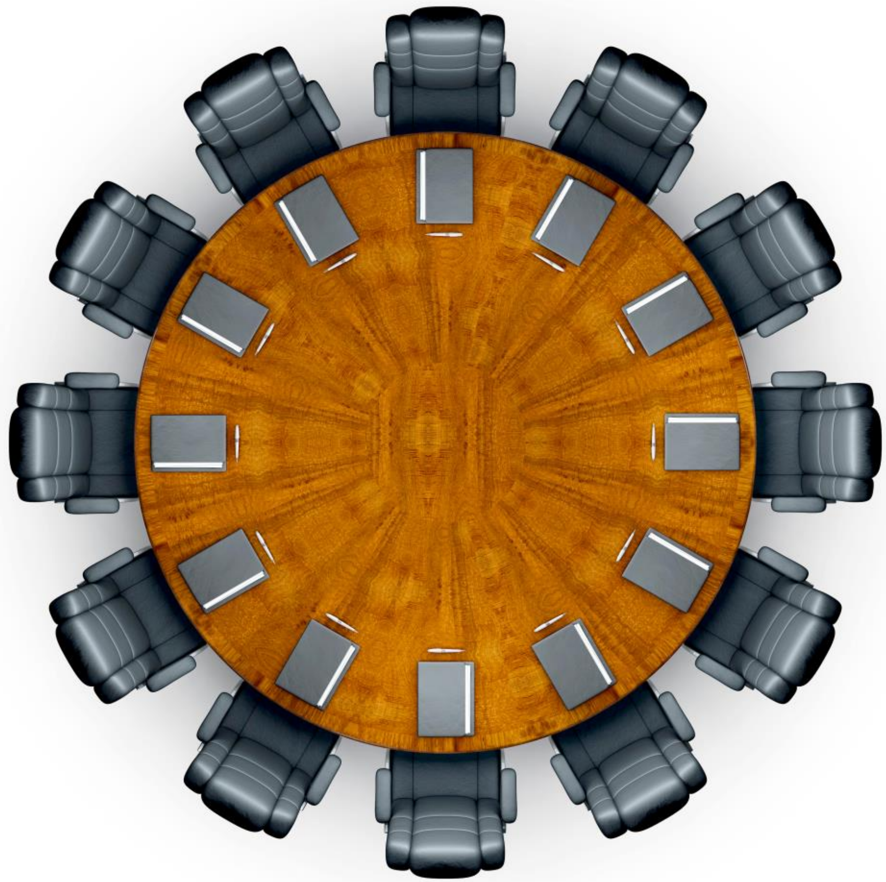


Hong Kong Insurance Implementation Support Group (HKIISG)

TRG Feb 2018 meeting highlights

20 March 2018

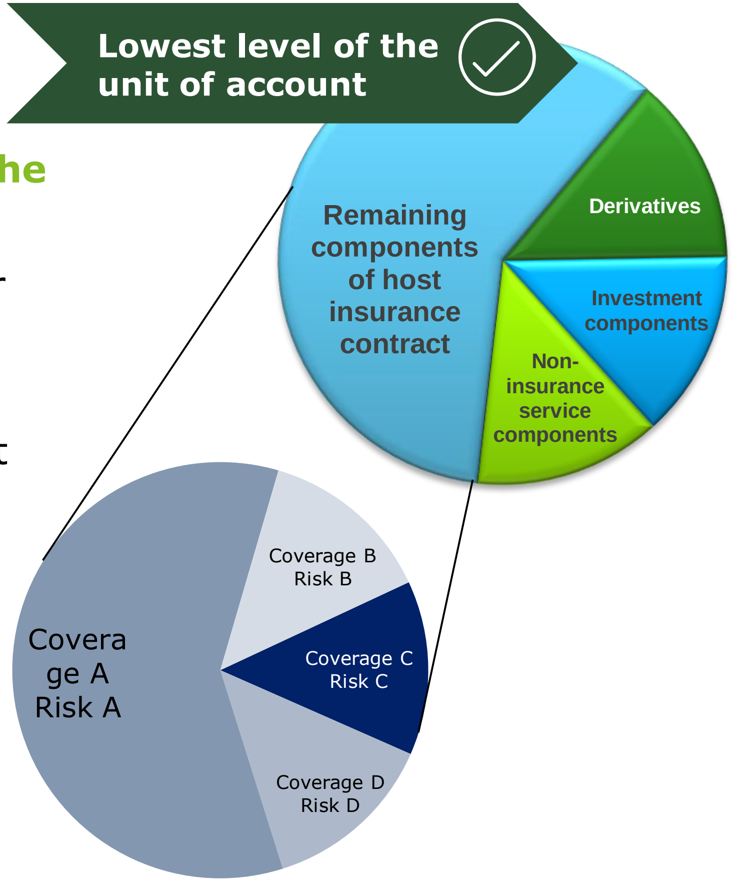
1. Summary of TRG 6 Feb meeting

AP01 Separation of insurance components of a single insurance contract (1/2)

Key highlights

Key question: Whether IFRS 17 permits the separation of insurance components of a single contract for measurement purposes

- IFRS 17 set out the requirements on **separating derivatives, investment components and distinct goods and non-insurance services**. IFRS 17 is then applied to all remaining components of the host insurance contract 17 and forms the **lowest level of the unit of account** in IFRS 17
- Remaining components of host insurance contract after unbundling would generally be considered the **lowest IFRS 17 level of the unit of account**
- There might be circumstances where one legal contract **does not reflect the underlying economic substance**
- Combining different multiple coverages into one legal insurance contract, **is not sufficient** to conclude that the **substance of the contractual rights and obligations is not** reflected
- Separation of insurance components within a legal contract is **not an accounting policy choice**



AP01 Separation of insurance components of a single insurance contract (2/2)

Key highlights cont'd

The discussion highlighted a few examples of what staff would consider in assessing when substance would override the form of a contract:

Cash flows interdependencies

Presence or not of cash flows interdependencies between insurance components within a single contract

Standalone contracts

Different components being sold by entity separately as standalone contracts, with coverages only sold as part of a combined contract indicating it is one contract

How are the components managed

Different components being managed separately in a pool of items sharing similar risks, with multi-coverage contracts managed together as such indicating one contract

Timing of lapses

Different components can be lapsed separately, with components lapsing together in all cases indicating it is one indivisible contract

AP02 Boundary of contracts with annual repricing mechanisms (1/2)

Key highlights

Certain insurance contracts have annual repricing mechanisms allowing policyholder a **guaranteed yearly renewal** of the policy at the price determined at a portfolio, rather than individual policyholder level. The contract reflects the risk of the particular policyholder only at issue date.

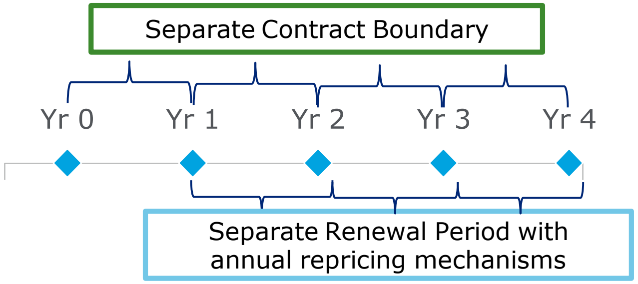
Contract Examples	Contract Features
A. Step-rated insurance contract	• Guaranteed to be renewable annually **with no further underwriting of the individual policyholder** • Premiums are determined for each age using a step-rated premium table and hence increased each year based on the table • The table is determined based on cash flow projections carried out over the potential future lifetime of a contract • Annual repricing at a portfolio level is done by replacing the table
B. Unit-linked investment component combined with an insurance component similar to the above	• Insurance component with characteristics similar to Example A • Annual repricing of the insurance fees at a portfolio level using step-rated fee tables • Unit-linked component is always priced based on the fair value of the underlying items • Contract can be repriced annually at a portfolio level by reassessing the step-rated tables

Key question: Whether insurance contracts with annual repricing mechanisms would have a contract boundary of one year or longer than one year, in particular, in response to IFRS 17 para. 34(b)

AP02 Boundary of contracts with annual repricing mechanisms (2/2)

Key highlights cont'd

- **Cash flows** resulting from renewal terms of an insurance contract with annual repricing mechanisms **should not** be included within the contract boundary, when new policyholders will receive the same price at that point in time



- A number of TRG members noted that there is a **substantial benefit** given to the existing policyholders when they can renew cover at the annual table rates without having to disclose the developments of their personal medical conditions
- The **smooth progression of rates** included in the premium table for different ages the entity is considering risks beyond one year
- The staff noted **policyholder risks** should only be considered in para. 34(b)
  - includes only the **insurance and financial risks** that the policyholder can transfer to the insurer but **excludes policyholder-behavior related risks** i.e. lapses or expenses risk, which are created by the contract

AP03 Boundary of reinsurance contracts held (1/2)

Background

- IFRS 17 Para 33 states that all **future cash flows** within the **boundary of each contract** in a group of insurance contracts shall be included in the **measurement of that group** while para 34 sets out the boundary when contractual and substantive obligations end
- The paper is on the **practical application** of the criteria in paragraph 34 to reinsurance contracts held, focusing on three reinsurance specific factors:
  - The **ability of reinsurer** to **exercise rights and have obligations** similar to those described by paragraph 34 of IFRS 17;
  - The **reinsurer's right to terminate coverage**; and
  - The **rights and obligations** of the holder of the reinsurance contract (sometimes called the cedant).
- The cash flows within the boundary of the reinsurance contract held arise from the **substantive rights and obligations of the cedant**
- The cedant's substantive right is to **receive services** from the reinsurer, while the substantive obligation is to **pay amounts to the reinsurer**

Key question: How to interpret IFRS 17 para. 34 regarding boundary of an insurance contract with respect to reinsurance contracts held

AP03 Boundary of reinsurance contracts held (2/2)

Key highlights

- Underlying contracts that are expected to be **issued in the future** but also covered by the reinsurance contract could be included in the reinsurance **contract boundary** if the reinsurer **does not reassess the risks** to be transferred from the underlying contracts to be issued in the future
- The **special concession** for **proportional coverage** reinsurance contracts in para 62 applies only as far as **initial recognition** is concerned
- Measurement of fulfilment cash flows reflects **consistency of assumptions** with underlying insurance contracts issued in para 63**,** **but only to the extent** that those **underlying contracts exist**
- **Inclusion of fulfilment cash flows** from expected future underlying reinsured insurance contracts **affects the CSM**
- **Unlocking of CSM** in the group of reinsurance contracts held and the **different discount rate** used for calculating the unlocking adjustments compared to the discount rate utilized to measure the changes in future cash flows will **create an asset or a liability in subsequent measurement**
- The TRG members agreed with IASB staff's view but noted **significant operational consequences**

AP04 Insurance acquisition cash flows paid on an initially written contract (1/3)

Background

- IFRS 17 Para 27 states that an entity can **recognize an asset or liability** for any insurance acquisition costs relating to a group of issued insurance contracts before the **group is recognized**
- "Insurance acquisition cash flows" are cash flows arising from the costs of selling, underwriting and starting a group of insurance contracts that are **directly attributable** to the portfolio of insurance contracts to which the group belongs
- Acquisition costs can include commissions paid **unconditionally for each initially written contract** and are determined to compensate the insurance intermediary for having secured a policyholder who is **expected to renew** the contract in future periods
- The renewals are new contracts outside the **original contract boundary**
- There is a question as to whether these commissions can be **allocated only to the initial group** or also to the groups where **renewed contracts** will be included

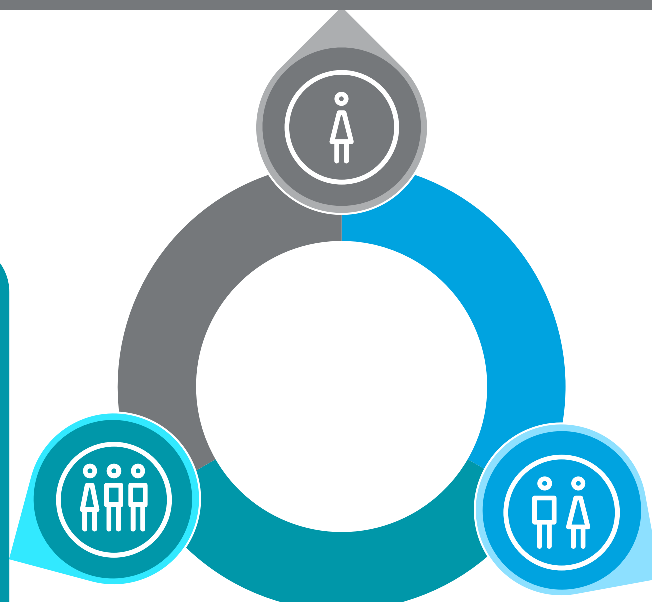
Key question: How to account for insurance acquisition cash flows ("CF") unconditionally paid when a contract is first written by the entity, expecting renewals outside the contract boundary to occur and has written the new business with this expectation on renewals?

AP04 Insurance acquisition cash flows paid on an initially written contract (2/3)

Background cont'd

The following views were submitted to TRG:

View A
- The acquisition cash flows incurred should be allocated to the **groups of contracts in existence** at that time
- Future groups to which renewed contracts will belong are not considered in the allocation of these commissions
- If in the same annual period there are contracts renewed and contracts initially written, they are **treated as separate groups**



View B
- These commissions relate to groups of contracts **initially recognised** and those groups to which **renewed contracts** are expected to **belong in the future**
- Therefore an asset is recognised for part of the commission that would be allocated to future groups
- If in the same annual period there are contracts renewed and contracts initially written, they are treated as separate groups

View C
- Similar to view A, except for interpretation of IFRS 17 level of aggregation requirements: if in the same annual period there are **contracts renewed** and **contracts initially written**, they are treated **as one group**.
- **Part of commission** incurred on writing initial contracts is allocated to **contracts renewed** in the same annual period

AP04 Insurance acquisition cash flows paid on an initially written contract (3/3)

Key highlights

Key outcomes of the discussion:

Some TRG members felt that it does not portray the economic substance, where the initial contracts end up being onerous and subsequent renewals more profitable.

A clarification was made that 'contracts issued' as referred to in IFRS 17 para 27 is used to distinguish them from 'contracts held' and this does not imply that these contracts have already have been issued by the time the acquisition cash flows have been incurred.

The renewals are new contracts outside the original contract boundary. Commissions cannot be allocated to groups where renewed contracts will be included.

The non-refundable commissions paid for each individually acquired contract are directly attributable only to the group of newly written contracts.

AP05 Determining quantity of benefits for identifying coverage units (1/2)

Background

- Para B119(a) defines the coverage units in the group as the quantity of coverage provided by the contracts in the group, determined by considering for each contract, the **quantity of benefits** provided and its **expected coverage duration**
- The paper identifies the following factors that might be included in determining the quantity of benefits

01 **Variability across periods** in the level of cover provided by the contracts in the group

02 **Likelihood of an insured** event occurring to the extent that likelihood affects the **expected duration of a contract**

03 **Likelihood of an insured event** occurring to the extent that likelihood affects the **amount expected to be claimed in a period**

IASB's view

AP05 Determining quantity of benefits for identifying coverage units (2/2)

Key highlights

- The staff argued that the **principle** in IFRS 17 is that **different levels of cover across periods** should be included in the **determination of the quantity of benefits**. Contracts that offer **larger benefits** to a policyholder would have a **larger number** of coverage units
- TRG discussion highlighted a concern with using **maximum level of cover** and the need to explain the concept of **’possible valid claim’**.
- It was decided to defer all discussion of coverage units till later date to ensure consistency in the TRG outcomes given the questions relating to insurance contracts with **investment components** will be discussed at a later meeting
- Staff encouraged TRG members to submit comments on the examples in the paper by the end of February

AP06 Insurance acquisition cash flows when using fair value transition (1/1)

Key highlights

Key question: Whether insurance acquisition cash flows that occurred prior to the transition date are recognized as revenue and expenses for reporting periods subsequent to the transition date, if fair value approach to transition is applied, referring to IFRS 17 para B121(b) and B125?

- Fair value approach can be applied if it is **impracticable** for an entity to **apply IFRS 17 fully retrospectively** for a group of insurance contracts
- IFRS 17 requires an allocation of acquisition cash outflows to each group and this allocation will reduce the group's CSM
- Application of the fair value approach on transition reflects only the **expectation of future** and **not past cash flows**
- Insurance revenue and insurance service expense recognized in a period include **equal and opposite amounts** related to insurance acquisition cash flows
- Insurance acquisition cash flows that **occurred prior** to the transition date **are not included in the measurement of the CSM**

AP07 Reporting on other questions submitted (1/2)

Background and summary of discussion

- Not all of the issues contained in this staff paper prompted comments from the TRG members
- The staff will consider **publishing educational materials** on these topics in the future to further support implementation
  - S04-Subsequent treatment of contracts acquired in their settlement period
  - S09- Allocating the contractual service margin at the end of a period to coverage units
  - S17- Using consistent assumptions for the measurement of reinsurance contracts held and the underlying insurance contracts
  - S20- Grouping contracts using the modified retrospective approach to transition
  - S23- Premiums received applying the premium allocation approach
  - S26- Variable fee approach when the return is shared based on amortised cost measurement of the underlying items

AP07 Reporting on other questions submitted (2/2)

Background and summary of discussion (cont')

- Questions that **do not meet submission criteria**
  - S03- Presentation of groups of insurance contracts in the statement of financial position
  - S10- Classification of contracts acquired in a business combination
  - S24- Discount rates applied to the contractual service margin for contracts without direct participation features
  - S25- Investment components
- These papers are being considered through **other than TRG process**
  - S06- Business combinations on transition - classification date
  - S16- Discount rate to be used to adjust the contractual service margin of reinsurance contracts held

2. After the TRG meeting & Next steps

After the Feb TRG meeting

- TRG members were specifically enquired on the below three topics after the TRG meeting on 6 February, in which these topics were included in the Agenda Paper 07:
  - S03- Presentation of groups of insurance contracts in the statement of financial position
  - S23- Premiums received applying the premium allocation approach
  - S04- Subsequent treatment of contracts acquired in their settlement period

Next steps

- The next TRG submission deadline is 21 March 2018
- The next TRG meeting will be held on 2 May 2018 in IASB office in London.
- The IFRS 17 coverage unit is a key topic for interpretation and will be brought back for further discussion in May.

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