Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Meeting Summary
Hong Kong Insurance Implementation Support Group (HKIISG)
26 July 2018

Attendance
HKICPA representatives
Gary Stevenson, Member, Financial Reporting Standards Committee (FRSC)
Christina Ng, Director, Standard Setting
Kam Leung, Associate Director, Standard Setting

HKIISG members
Grace Li (representing Sai-Cheong Foong), AIA Group Limited
Kevin Lee, AXA China Region Insurance Company Limited
Kevin Wong, FWD Life Insurance Company (Bermuda) Limited
Flora Loo (representing Alexander Wong), Hang Seng Insurance
Kenneth Dai, Manulife Asia
Devadeep Gupta (representing Nigel Knowles), Prudential Hong Kong Limited
Joyce Lau, Target Insurance Company, Limited
Doru Pantea, EY Hong Kong
Erik Bleekrode, KPMG China
Chris Hancorn, PwC Hong Kong

Dial-in
Sally Wang, China Pacific Life Insurance Co., Ltd
Candy Ding, Ping An Insurance (Group)
Francesco Nagari, Deloitte Hong Kong

Apologies
Ronnie Ng, China Overseas Insurance Limited

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. Opening remarks

Paper 02 on the loss component is deferred until the 12 September HKIISG meeting. Any questions or comments on the paper should be sent to HKICPA staff in the meantime.

2. Consider HKIISG submission on interaction between IFRS 9 *Financial Instruments* and IFRS 17 *Insurance Contracts* on transition

Mr. Kevin Wong presented paper 03. The submission observes that whilst IFRS 17 requires a fully retrospective approach (unless deemed impractical); IFRS 9 does not have this requirement (IFRS 9 paragraphs 7.2.1 and 7.2.15). Instead, entities may elect to restate prior periods on adoption of IFRS 9, if and only if, it is possible to restate them without the benefit of hindsight. Alternatively, entities may elect not to restate prior periods and instead adjust opening retained earnings in the period of initial application for any transition differences.

The submission outlines a scenario whereby IFRS 17 and IFRS 9 are both adopted on 1 January 2021 for:

- An insurance contract issued on 1 January 2020.

- On adopting IFRS 17, the contract meets the variable fee approach criteria and the entity elects the OCI approach to disaggregate the finance income and expenses.
- On adopting IFRS 9, the entity reclassifies its underlying items from AFS through other comprehensive income to fair value through profit and loss. The entity elects not to restate prior periods and instead adjusts the opening retained earnings in the period of initial application. That is, any OCI reserve will be transferred to the opening retained earnings balance on transition.
- During 2020 there is a drop in interest rates, resulting in an increase in fair value of CU$10 on both the financial asset and the insurance liability.
- All other factors are assumed to be constant for simplicity

The question is how to recognize the CU$10 fair value change for the insurance liability and the financial asset on transition. The submission outlines two views.

<u>Apply IFRS 9 first, then IFRS 17</u>
During the year 2020, the CU$10 fair value change is recognized in OCI for both the financial asset under IAS 39 and insurance liability under IFRS 17. At 1 January 2021, the financial asset's OCI reserve is transferred to opening retained earnings when the financial asset is reclassified from AFS to FVTPL. However, the OCI reserve for the insurance liability remains – creating what appears to be a permanent difference.

One member noted that the permanent difference created in OCI is clearly linked to an entity's decision not to retrospectively apply IFRS 9 in conjunction with the retrospective application of IFRS 17. It was further noted that the standard does not prescribe how an entity would eliminate the permanent difference created.

This member commented that although this application of IFRS 9 and 17 is not technically incorrect, an entity should supplement the disclosure on its transition approaches by documenting how they intend to eliminate the permanent difference, which may include transferring the difference to retained earnings:

- at transition (similar to a transition adjustment in the movements of equity); or
- when the group of insurance contracts is derecognized from the financial statements.

Since this difference is created purely due to timing difference in applying IFRS 9, it should not be transferred to the profit and loss. In both cases described above the accounting would be done as a movement in equity).

One member noted that if IFRS 9 is not retrospectively applied for this specific fact pattern, the application of IFRS 17 results in the recognition of an OCI balance for the insurance liability which is equal to the OCI balance resulting from the underlying item (AFS under IAS 39). This results in no net impact to the OCI. On transition to IFRS 17, this member thinks that a logical approach to address the OCI balance of the insurance liability is to transfer it to retained earnings (aligned with how the OCI balance of the underlying item is dealt with on transition to IFRS 9). This is because there should not be any net impact to the OCI for consistency.

<u>Apply IFRS 17 first, then IFRS 9</u>
At 2021, the CU$10 fair value change for both the insurance liability and financial asset is recognized through profit and loss under IFRS 17 and IFRS 9, respectively. There is no impact to the OCI balance at transition or in retrospective application.

Most members expressed a preference for applying IFRS 9 retrospectively as part of the retrospective application of IFRS 17, with one member noting that there is nothing in IFRS 9 which prevents entities from doing so.

<u>Other considerations</u>
One member commented that this question is possibly more pervasive than the fact pattern outlined in the submission. That is, the creation of a permanent difference in OCI

could also be possible in the following scenarios:

- Post-transition for VFA contracts
  For example: if there is a subsequent change in business model / reclassification of financial assets under IFRS 9; or change in accounting policy for the disaggregation of finance income and expenses under IFRS 17.
- At transition for VFA contracts
  As illustrated by this submission
- The general measurement model for indirect participating contracts
  For example: for those indirect participating contracts which fail the VFA criteria but elect to use the OCI approach

Mr. Francesco Nagari volunteered to submit a paper for the 12 September meeting which will detail these other considerations.

Finally, one member commented that it would be questionable why an entity would elect to apply the OCI option for a group of contracts when it meets the criteria for VFA. This is because the VFA approach theoretically eliminates volatility in the profit and loss arising from fair value changes in the underlying financial assets and insurance liabilities. Electing the OCI option in this scenario would seem to create unnecessary operational complexity.

Action/Conclusion:

- Mr. Francesco Nagari will submit a paper for the 12 September meeting which will detail these other considerations when electing the OCI approach.

3. Update from staff on implementation challenges/issues

Transition approach

At the 27 June meeting, HKICPA staff updated members that they had reached out to IASB staff to understand why previous IASB TRG submissions on the transition approach were deemed to be answerable using only the words in IFRS 17 and hence not discussed at the TRG meetings.

IASB staff noted that there is no additional information in the submissions received that is not already disclosed in the IASB staff papers. However, IASB staff are open to discuss a specific fact pattern regarding transition that is particularly troublesome with HKIISG members. Therefore, HKICPA staff called for submissions relating to the transition approach to be discussed at a future HKIISG meeting. Following this, HKICPA staff proposes to assess next steps in terms of whether further discussion between IASB staff and HKIISG members is necessary.

Discount rate

For background to this question, readers should refer to paper 04 of the 10 May meeting

At the 10 May meeting, members wanted HKICPA staff to further clarify with IASB staff the application of IFRS 17 paragraph B73: "To determine the discount rates at the date of initial recognition of a group of contracts described in paragraphs B72(b)–B72(e), an entity may use weighted-average discount rates over the period that contracts in the group are issued…" This is because members think that paragraph B73 can be applied whenever contracts are initially recognized during the year—that is, a weighted average discount rate is applied for initial recognition of each contract issued in a group during the year. On balance sheet date however, the current discount rate will be applied in measuring a group of contracts (paragraph B72(a)).

IASB staff confirmed that the current rate must be used for initial recognition of fulfillment cash flows whenever an insurance contract is recognized (paragraph B72(a)).

Members expressed their surprise at this confirmation of how paragraph B73 is intended to be applied. A few members requested HKICPA staff to elaborate to IASB staff how this application would create complicated operational issues, such as:

- An entity would need to recognize each individual contract using the market consistent yield curve applicable to the day in which the contract is issued. This would prevent the operational simplification of batch processing of the new contract issued in a given period (e.g. a month) using a discount rate yield curve that is the average for a group of contracts issued during that period. That period could also be extended to the full year if no interim financial statements are produced.
- Without the simplification that allows the use of an average discount rate yield curve for initial recognition, entities would have to calculate as many discount rate curves for each day in which contracts have been issued and to do that for each group of insurance contracts where the measurement for initial recognition is required; they would need to calculate the discount rate curve for each group of insurance contracts for each of the subsequent balance sheet reporting dates (interim and annual); and use the resulting weighted average discount rate curve only for the purposes set out in B72(b) to (e).
- This means entities would require a system that deals with the yield curve on a daily basis for the purposes of B72(a) and that calculates and stores a resulting average yield curve for the purposes of B72(b) to (e).
- This is appears to make the cost for implementing the IFRS 17 discount rate requirements greater than many members had anticipated, and adds operational complexity for the retrospective application of IFRS 17 because an entity would need to trace each individual contract back to the rate existing at the date of initial recognition.

One member noted that perhaps the analogy of B73's application is similar to how foreign exchange rates are applied: i.e. a transaction is recognized at its spot FX rate when it occurs. Nevertheless, this member noted that this is not reasonable for IFRS 17 as the unit of account is a group of contracts issued in a year, not an individual contract. This member noted that average discount rate would still need to be applied for practical purposes.

HKICPA staff commented that if this issue was raised again to IASB staff, members would need to provide details of why, and how, this particular requirement is a challenge to implement. Mr. Francesco Nagari and Mr. Chris Hancorn volunteered to provide an outline of these challenges.

<u>Meeting between Insurance Authority and HKICPA Insurance Regulatory Advisory Panel</u>
HKICPA staff updated members on a meeting between IA and the HKICPA's IRAP on 18 July. It was noted that:

- IRAP had prepared a working draft discussion paper (DP) on possible approaches to using HKFRS 17 *Insurance Contracts* in the future Hong Kong Risk-Based Capital (RBC) Regime.
- IA and IRAP discussed the DP at the meeting. Overall, IA noted that while they are open minded to considering possible approaches whereby HKFRS 17 requirements can be leveraged in the development of its new RBC Regime to alleviate the administrative burden for insurers, these possibilities are constrained by the fact that they ultimately have to adhere to the Insurance Core Principles (ICP) issued by the International Association of Insurance Supervisors.
- The ICP has different objectives from financial reporting standards, and therefore this will result in some reconciling differences between the new RBC Regime and HKFRS 17.
- IA and IRAP intend to continue having this type of dialogue.

<u>European Financial Reporting Advisory Group (EFRAG)</u>
HKICPA staff provided members an update of its exchange of views with the EFRAG Board and Technical Experts Group in early July. Other national standard setters invited to this exchange of views were Australia, Canada, Japan and the United States.

At the EFRAG Board meeting in early July:

- Feedback was received from representatives of the CFO Forum, a reinsurance company, and the European investor community.
- The CFO Forum outlined many issues with IFRS 17, but did not identify what were the priority issues. The CFO Forum also indicated that preparers need more time to implement the standard, but did not specify how much more time.
- Results of EFRAG's case studies on insurers implementing IFRS 17 were discussed with the conclusion that more quantitative information for further analysis needs to be obtained from preparers.
- Feedback from European investors indicated that they support the endorsement of IFRS 17 because theoretically, it should be a better standard compared to IFRS 4.
- EFRAG Board will receive a recommendation from the EFRAG TEG on whether to endorse IFRS 17 in September.

Action/Conclusion:

- Members are requested to provide submissions relating to the transition approach to be discussed at a future HKIISG meeting. Following this, HKICPA staff proposes to assess next steps in terms of whether further discussion between IASB staff and HKIISG members is necessary.
- Mr. Francesco Nagari and Mr. Chris Hancorn will provide an outline of the operational challenges in applying a current discount rate for the fulfillment cash flows at initial recognition.

[Post-meeting note:
The operational challenges in applying a current discount rate for the fulfillment cash flows at initial recognition has been incorporated under the section entitled "Discount rate" following input from an HKIISG member.]

4. Any other business

Two members provided further updates in relation to developments in Europe:

- The CFO Forum sent a letter to the IASB on 16 July which stated that IFRS 17 should be reopened to resolve material outstanding issues.
- The EFRAG TEG met again on 25 July to discuss a further analysis of each issue raised to the ERFAG Board in early July.