PAPER: 02B

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Potential implementation question

Premium Allocation Approach ("PAA") is only allowed under IFRS 17 if:

1.The coverage period for the group of insurance contracts is one year or less; or
2.The PAA would result in a “reasonable approximation” to the General Measurement Model ("GMM")

It is expected that the primary beneficiaries of the PAA will be underwriters of short-duration contracts (e.g. typical P&C contracts of one year or less).

However, under the PAA, if at any time after the initial recognition the group of insurance contracts under the simplified model become onerous (i.e. loss making), measurement under the PAA is essentially discontinued and replaced with measurement principles consistent with the GMM (with limited exceptions). This means that even an entity that solely issues short-duration insurance contracts must still have the ability to apply the GMM if situations arise where a group of their contracts become onerous.

In additional to the cashflow directly associated to the insurance contracts (acquistion costs, underwriting expenses, insurance claims and loss adjustment expenses), should management expenses be allocated to the insurance contracts when considering if they are onerous or not? If yes, any basis for such allocation.

Paragraph of HKFRS/IFRS 17 *Insurance Contracts*

Onerous contracts
47 An insurance contract is onerous at the date of initial recognition if the fulfilment cash flows allocated to the contract, any previously recognised acquisition cash flows and any cash flows arising from the contract at the date of initial recognition in total are a net outflow.

Analysis of the question

Based on the definition under HKFRS 17, it is arguable if management expenses are arising from the insurance contracts. However, when Insurance Authority's business return, 'Underwriting Profit/ (Loss) is calculated by subtracting Net Commissions Payable, Net Claims Incurred, Unexpired Risks Adjustment and Management Expenses from Net Earned Premiums. It shows management expenses should form a part in the determination if the insurance contract is onerous. However, according to current practice, not all general insurers have the same approach towards to allocation of management expenses to each lines of business. Some general insurers allocate all management expenses but some just allocate a portion of it (particularly for group companies with shared resources).

This question will largely affect general insurers' ability to adopt PAA at initial recognition. Particularly for those who write Motor and EC business. As you can see from P.2 of 2017 Q4 quarterly statistics (https://www.ia.org.hk/en/infocenter/statistics/files/4q17gen.pdf), both lines are in underwriting loss after deducting management expenses.