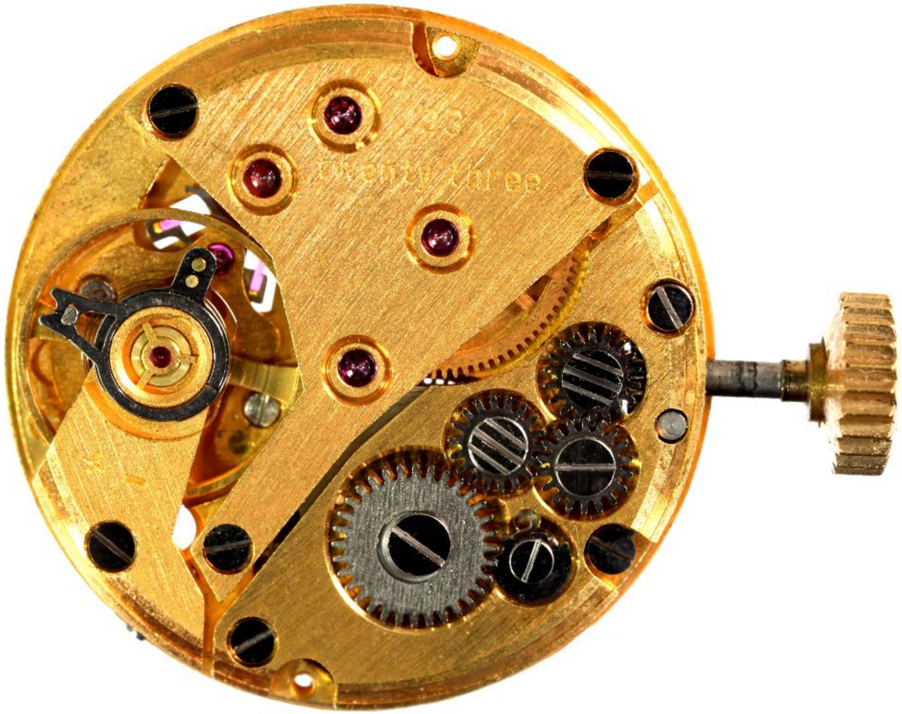


IFRS 17 Transition Resource Group Meeting

A summary of the meeting highlights

Francesco Nagari, Deloitte Global IFRS Insurance Leader | 14 February 2018

Agenda

- Introduction
- Background of the TRG papers
- Summary and key output of the TRG discussions
- Next steps

Introduction

- **The purpose of the TRG is to:**
  - **Invite discussion and analysis of potential stakeholder issues arising from implementation of IFRS 17;**
  - **To provide a public forum for stakeholders to learn about the new requirements from IFRS 17; and**
  - **To help the IASB determine whether additional action is needed to support the implementation of IFRS 17, such as providing clarification or issuing other guidance**
- **This was the first meeting where submissions to the TRG were discussed and it covered a number of areas inclusive of:**
  - **different applications of the contract boundary requirements,**
  - **treatment of acquisition costs for future expected renewals,**
  - **accounting for multi-coverage insurance contracts and**
  - **how to define CSM coverage units.**

Separation of insurance components of a single insurance contract

Background

- IFRS 17 sets 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
- IFRS 17 also sets out the requirements on combining a set or a series of insurance contracts with the same or related counterparty that may achieve or be designed to achieve an overall commercial effect
- A question arises whether an entity is permitted or required to split multi-coverage insurance contracts and include them in different groups
- The TRG submission also asks whether it is possible or required to split components of a reinsurance contract and account for them as separate reinsurance contracts held

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

Separation of insurance components of a single insurance contract
Summary of discussion

- The staff highlighted that a contract would generally be considered as the lowest IFRS 17 unit of account after unbundling is completed
- Many TRG members agreed with staff's view however noted that there might be circumstances where one legal contract does <u>not</u> reflect the underlying economic substance
- The IASB staff noted that combining different multiple coverages into one legal insurance contract, is <u>not</u> sufficient to conclude that the substance of the contractual rights and obligations is <u>not</u> reflected
- Separation of insurance components within a legal contract is <u>not</u> an accounting policy choice. However, the overarching principle of the IFRS Conceptual Framework that substance prevails over form remains in place for all IFRS, including IFRS 17 as a key piece of guidance on the interpretation of all IFRS requirements.

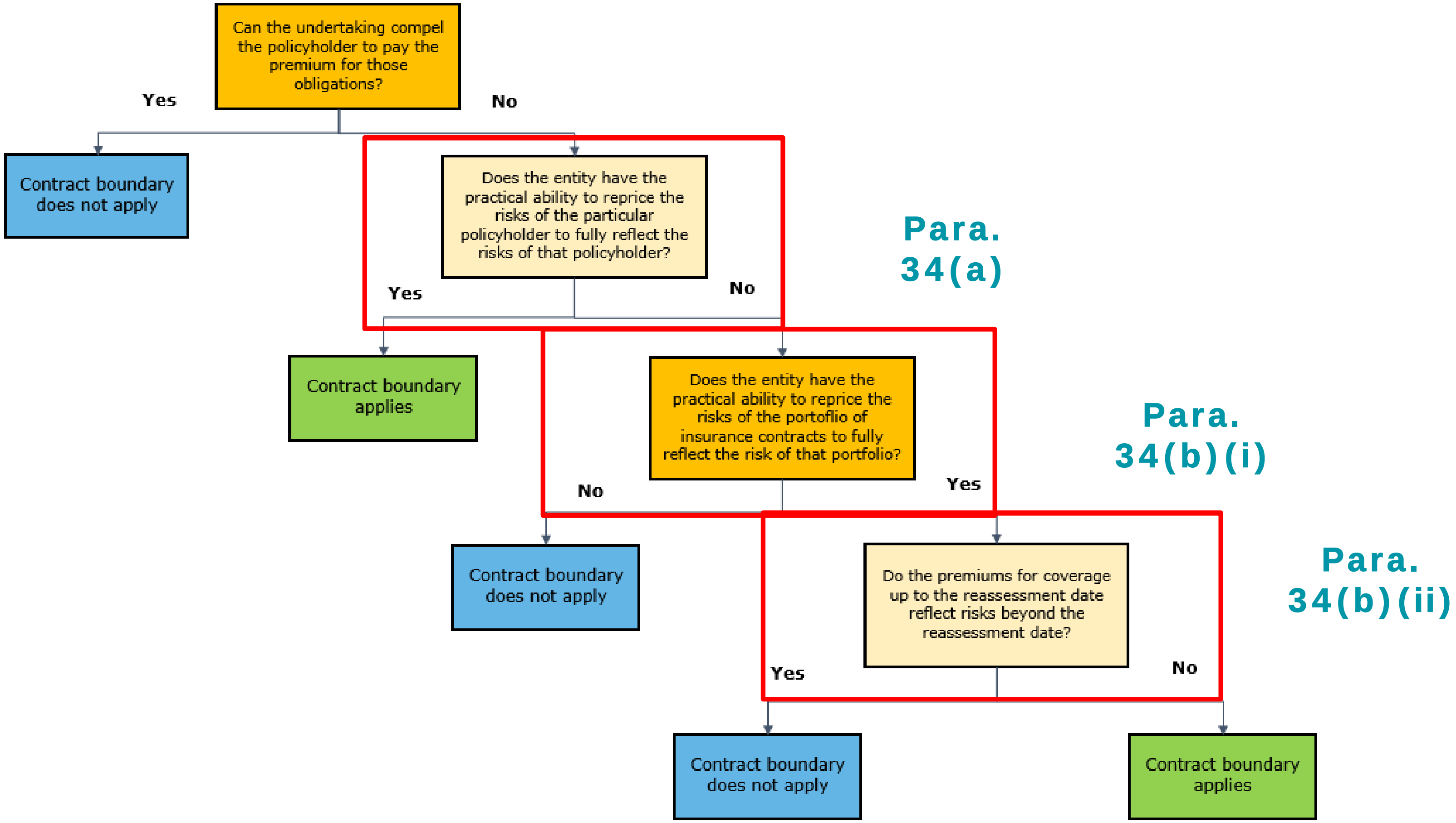
Separation of insurance components of a single insurance contract
Summary of discussion cont'd

- The discussion highlighted a few examples of what staff would consider in assessing when substance would override the form of a contract:
  - Presence or not of cash flows interdependencies between insurance components within a single contract;
  - Different components can be lapsed separately, with components lapsing together in all cases indicating it is one indivisible contract;
  - 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; and
  - Different components being managed separately in a pool of items sharing similar risks, with multi-coverage contracts managed together as such indicating one contract.

Boundary of contracts with annual repricing mechanisms

Recap of contract boundary requirements

The ability of the entity to fully reflect the risks of a particular policyholder in the price charged or level of benefits provided sets a contractual boundary



Boundary of contracts with annual repricing mechanisms
Background

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)**

Boundary of contracts with annual repricing mechanisms
Summary of discussion

- **Mixed views were noted on this paper on the determination of the contract boundary, in particular, in regards to the type of relevant risks stated in para. 34(b)**
- **The staff confirmed the analysis in their paper that the 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 that an entity should consider exclusively policyholder risks in the application of para. 34(b) rather than any risks factored into the pricing**
- **Policyholder risks 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**

Insurance acquisition cash flows paid on an initially written contract

Background

- IFRS 17 Para 27 states that an entity can recognise an asset or liability for any insurance acquisition costs relating to a group of issued insurance contracts before the group is recognised
- "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?**

Insurance acquisition cash flows paid on an initially written contract
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**

Insurance acquisition cash flows paid on an initially written contract

Summary of discussion

- The staff view is that the non-refundable commissions paid for each individually acquired contract are directly attributable only to the group of newly written contracts
- Overall, many TRG members agreed with the staff view on the fact pattern presented in the paper, but felt that it does not portray the economic substance, where the initial contracts end up being onerous and subsequent renewals more profitable rather than reporting all these groups of contracts with a similar profitability, all other things being equal
- 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

Insurance acquisition cash flows when using fair value transition

Background

- **Para C5 states that 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**
- **Insurance revenue and insurance service expense recognised in a period include equal and opposite amounts related to insurance acquisition cash flows, resulting in no impact on the recognised insurance service result**

Key question: **Whether insurance acquisition cash flows that occurred prior to the transition date are recognised 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?**

Insurance acquisition cash flows when using fair value transition
Summary of discussion

- **The IASB staff highlighted that the application of the fair value approach on transition reflects only the expectation of future and not past cash flows, including past insurance acquisition cash flows**

- **Insurance acquisition cash flows that occurred prior to the transition date are not included in the measurement of the CSM and should not be recognised as revenue and expenses for reporting periods subsequent to the transition date**

- **TRG members agreed with IASB staff view**

Determining quantity of benefits for identifying coverage units
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 in determining the quantity of benefits
  - **Variability across periods** in the level of cover provided by the contracts in the group
  - Likelihood of an insured event occurring to the extent that likelihood affects the **expected duration of a contract**
  - Likelihood of an insured event occurring to the extent that likelihood affects the **amount expected to be claimed in a period**
- Pattern of profit recognition reflects the service provided over the whole of the coverage period, and not just when a claim is incurred

Key question: How are coverage units determined?

Determining quantity of benefits for identifying coverage units
Summary of discussion

- 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

Boundary of reinsurance contracts held
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**

Boundary of reinsurance contracts held cont′d
Summary of discussion

- 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 utilised 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

Reporting on other questions submitted
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**
- **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**

Next steps

IASB

- The IASB will receive a public debriefing on the TRG at its meeting on 22 February. A summary of the outcomes of the meeting has been released on 13 February.
- 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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- IFRS in Focus – IFRS 17 TRG Meeting 6 February 2018 has been issued on IASPlus https://www.iasplus.com/en/publications/global/ifrs-in-focus/2018/trg-insurance-meeting

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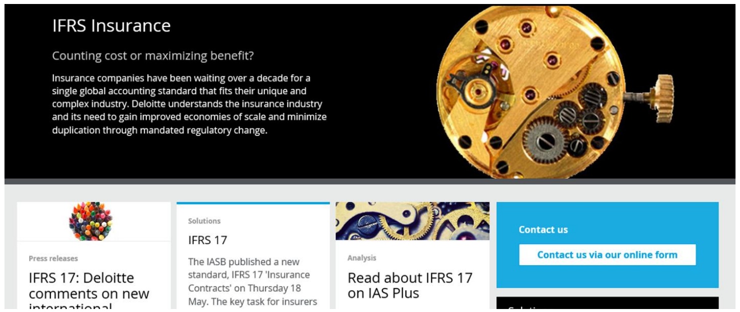

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