

## STAFF PAPER

May 2018

## IASB Meeting

<b>Project</b>	<b>Insurance Contracts</b>		
<b>Paper topic</b>	Summary of the Transition Resource Group for IFRS 17 <i>Insurance Contracts</i> meeting held on 2 May 2018		
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### Summary of the Transition Resource Group for IFRS 17 *Insurance Contracts* meeting held on 2 May 2018

1. The Transition Resource Group for IFRS 17 *Insurance Contracts* (TRG) held a meeting on 2 May 2018 at the London office of the IFRS Foundation. These notes summarise the discussions.
2. Agenda Paper 2 for the May 2018 meeting of the International Accounting Standards Board (Board) updated the Board on the TRG meeting held on 2 May 2018. Agenda Paper 2A for the May 2018 Board meeting provided the Board a copy of this summary.
3. The discussions at the TRG meetings are based on the agenda papers that provide an accounting analysis of implementation questions submitted to the TRG. These agenda papers provide a basis for TRG members, as industry experts involved in IFRS 17 implementation, to understand the implementation questions raised and share their views on the accounting analysis. Although the analysis in an agenda paper may be relevant to other fact patterns, all relevant facts and circumstances of a particular fact pattern need to be evaluated when applying IFRS 17.
4. TRG members discussed the following topics:
  - (a) combination of insurance contracts;
  - (b) determining the risk adjustment for non-financial risk in a group of entities;

- (c) cash flows within the contract boundary;
  - (d) boundary of reinsurance contracts held with repricing mechanisms; and
  - (e) determining the quantity of benefits for identifying coverage units.
5. TRG members received a report on other questions submitted.
6. TRG members received a report on outreach performed by staff to obtain further details about implementation challenges TRG members raised at the February 2018 meeting of the TRG. The outreach relates to three submissions on topics that TRG members identified as causing implementation challenges because the requirements in IFRS 17 represent a significant change from existing practices. This paper was reported to the Board in Agenda Paper 2C for the May 2018 Board meeting.

***Combination of insurance contracts (Agenda Paper 1)***

7. Agenda Paper 1 addresses a submission about when it may be necessary to treat a set or series of insurance contracts as a whole applying paragraph 9 of IFRS 17.
8. TRG members discussed the analysis in Agenda Paper 1 and observed that:
- (a) a contract with the legal form of a single contract would generally be considered on its own to be a single contract in substance. However, there may be circumstances where a set or series of insurance contracts with the same or a related counterparty reflect a single contract in substance.
  - (b) the fact that a set or series of insurance contracts with the same counterparty are entered into at the same time is not, in itself, sufficient to conclude that they achieve, or are designed to achieve, an overall commercial effect. Determining whether it is necessary to treat a set or series of insurance contracts as a single contract involves significant judgement and careful consideration of all relevant facts and circumstances. No single factor is determinative in applying this assessment.
  - (c) the following considerations might be relevant in assessing whether a set or series of insurance contracts achieve, or are designed to achieve, an overall commercial effect:
    - (i) the rights and obligations are different when looked at together compared to when looked at individually. For example, if the rights and

obligations of one contract negate the rights and obligations of another contract.

(ii) the entity is unable to measure one contract without considering the other. This may be the case where there is interdependency between the different risks covered in each contract and the contracts lapse together. When cash flows are interdependent, separating them can be arbitrary.

(d) the existence of a discount, in itself, does not mean that a set or series of contracts achieve an overall commercial effect.

9. TRG members also observed that the principles for combining insurance contracts in paragraph 9 of IFRS 17 are consistent with the principles for separating insurance components from a single contract, as discussed at the February 2018 meeting of the TRG.

***Determining the risk adjustment for non-financial risk in a group of entities (Agenda Paper 2)***

10. Agenda Paper 2 addresses a submission about the level at which the risk adjustment for non-financial risk is required to be determined.

11. The first question is whether, in the individual financial statements of the subsidiary, the risk adjustment for non-financial risk for groups of insurance contracts issued by the subsidiary should reflect the degree of risk diversification available only to the consolidated group as a whole.

12. The second question is whether, in the consolidated financial statements of the group of entities, the risk adjustment for non-financial risk for groups of insurance contracts issued by entities in the group should reflect the degree of risk diversification that is available only to the consolidated group as a whole.

13. TRG members discussed the analysis in Agenda Paper 2 and observed that:

(a) IFRS 17 does not specify the level at which to determine the risk adjustment for non-financial risk.

(b) in the individual financial statements of the issuing entity, the degree of risk diversification that occurs at a level higher than the issuing entity level is required to be considered in the determination of the risk adjustment for non-

financial risk if, and only if, it is considered when determining the compensation the issuing entity would require for bearing non-financial risk related to insurance contracts it issues. Equally, risk diversification that occurs at a level higher than the issuing entity level must not be considered when determining the risk adjustment for non-financial risk if it is not considered when determining the compensation the issuing entity would require for bearing non-financial risk related to insurance contracts it issues.

14. Some TRG members agreed with the staff analysis that only the issuing entity that is party to the contract determines the compensation the entity would require for bearing non-financial risk related to insurance contracts that the entity issues. Therefore, for a group of insurance contracts issued by an entity that is party to the contracts, there is one risk adjustment for non-financial risk. This means that for a group of insurance contracts the risk adjustment for non-financial risk at the consolidated group level is the same as the risk adjustment for non-financial risk at the individual issuing entity level.
15. The analysis in paragraph 14 of this paper precludes different measurement of the risk adjustment for non-financial risk for a group of insurance contracts at different reporting levels. Some TRG members commented that they could read the requirements in IFRS 17 differently. Those TRG members read the requirements as requiring different measurement of the risk adjustment for non-financial risk for a group of insurance contracts at different reporting levels if the issuing entity would require different compensation for bearing non-financial risk than the consolidated group would require. TRG members observed that:
  - (a) if the risk adjustment for non-financial risk is determined differently at different reporting levels in the group structure there could be multiple risk adjustments for non-financial risk for the same group of insurance contracts, depending on the reporting level;
  - (b) applying the requirements in IFRS 17 as analysed by the staff in paragraph 14 of this paper would be more practical to implement; and
  - (c) a group of entities must apply the requirements consistently across all groups of insurance contracts.

16. TRG members also observed that in some cases the compensation that an entity requires for bearing non-financial risk could be evidenced by capital allocation in a group of entities.

***Cash flows within the contract boundary (Agenda Paper 3)***

17. Agenda Paper 3 addresses some submissions that ask how to apply the requirements in paragraph 34 of IFRS 17 regarding:

- (a) the practical ability to set a price at a future date that fully reflects the risks of a contract or portfolio from that date; and
- (b) options to add insurance coverage.

***A. Practical ability to set a price at a future date that fully reflects the risks of a contract or portfolio from that date***

18. Agenda Paper 3 addresses submissions about what constraint or limitations, other than those arising from the terms of an insurance contract, would be relevant in assessing the practical ability of an entity to reassess the risks of the particular policyholder (or of the portfolio of insurance contracts that contains the contract) and set a price or level of benefits that fully reflects those risks.

19. TRG members discussed the analysis in Agenda Paper 3 and observed that:

- (a) a constraint that equally applies to new contracts and existing contracts would not limit an entity's practical ability to reprice existing contracts to reflect their reassessed risks.
- (b) when determining whether it has the practical ability to set a price at a future date that fully reflects the reassessed risks of a contract or portfolio, an entity shall:
  - (i) consider contractual, legal and regulatory restrictions; and
  - (ii) disregard restrictions that have no commercial substance.
- (c) IFRS 17 does not limit pricing constraints to contractual, legal and regulatory constraints. Market competitiveness and commercial considerations are factors that an entity typically considers when pricing new contracts and repricing existing contracts.

(d) a constraint that limits an entity's practical ability to price or reprice contracts differs from choices that an entity makes (pricing decisions), which may not limit the entity's practical ability to reprice existing contracts in the way envisaged by paragraph B64 of IFRS 17.

20. TRG members also observed that an entity should apply judgement to decide whether commercial considerations are relevant when considering the requirements in paragraph 34 of IFRS 17.

*B. Options to add insurance coverage*

21. Agenda Paper 3 addresses submissions about how to determine the contract boundary of insurance contracts that include an option to add insurance coverage at a future date, while it is assumed that the entity has no right to compel the policyholder to pay premiums. For those contracts, the entity is obligated to provide additional coverage if the policyholder exercises the option. The submissions distinguish between:

- (a) terms that are guaranteed by the entity—ie the entity sets the premiums for the additional coverage at inception and cannot reprice the premiums for the additional coverage to reflect reassessed risks of the policyholder (or of the portfolio that contains the contract); and
- (b) terms that are not guaranteed by the entity—ie the entity sets the premiums for the additional coverage only when the policyholder exercises the option.

22. TRG members discussed the analysis in Agenda Paper 3 and observed that:

- (a) an option to add insurance coverage at a future date is a feature of the insurance contract.
- (b) an entity should focus on substantive rights and obligations arising from that option to determine whether the cash flows related to the option are within or outside the contract boundary.
- (c) unless the entity considers that an option to add coverage at a future date is a separate contract, the option is an insurance component that is not measured separately from the remainder of the insurance contract.

- (d) if an option to add insurance coverage is not a separate contract and the terms are guaranteed by the entity, the cash flows arising from the option would be within the boundary of the contract because the entity cannot reprice the contract to reflect the reassessed risks when it has guaranteed the price for one of the risks included in the contract.
- (e) if an option to add insurance coverage is not a separate contract and the terms are not guaranteed by the entity, the cash flows arising from the option might be either within or outside of the contract boundary, depending on whether the entity has the practical ability to set a price that fully reflects the reassessed risks. The analysis in Agenda Paper 3:
  - (i) assumed that the option to add insurance coverage at a future date created substantive rights and obligations; and
  - (ii) noted that, if an entity does not have the practical ability to reprice the whole contract when the policyholder exercises the option to add coverage, the cash flows arising from the premiums after the option exercise date would be within the contract boundary.

Although not discussed in Agenda Paper 3, TRG members expressed different views about whether an option with terms that are not guaranteed by the entity would create substantive rights and obligations.

- (f) if the cash flows arising from an option to add coverage at a future date are within the contract boundary, the measurement of a group of insurance contracts is required to reflect, on an expected value basis, the entity's current estimates of how the policyholders in the group will exercise the option.

***Boundary of reinsurance contracts held with repricing mechanisms (Agenda Paper 4)***

- 23. Agenda Paper 4 addresses a submission about how the boundary of a reinsurance contract held should be determined when the reinsurer has the right to reprice remaining coverage prospectively. In the fact pattern provided in the submission:
  - (a) the reinsurer can choose either:
    - (i) not to exercise the right to reprice. In this case, the entity (the holder of the contract) is committed to continue paying premiums to the reinsurer; or

- (ii) to exercise the right to reprice. In this case, the entity has the right to terminate coverage.
  - (b) the reinsurer can adjust premium rates at any time, subject to a minimum three-month notice period.
24. TRG members discussed the analysis in Agenda Paper 4 and observed that:
- (a) for reinsurance contracts held, cash flows are within the contract boundary if they arise from substantive rights and obligations that exist during the reporting period in which the entity is compelled to pay amounts to the reinsurer **or** in which the entity has a substantive right to receive services from the reinsurer [emphasis added].
  - (b) a right to terminate coverage that is triggered by the reinsurer's decision to reprice the reinsurance contract is not relevant when considering whether a substantive obligation to pay premiums exists. Such a right is not within the entity's control and therefore the entity would continue to be compelled to pay premiums for the entire contractual term.
  - (c) the entity's expectations about the amount and timing of future cash flows, including with respect to the probability of the reinsurer repricing the contract, would be reflected in the fulfilment cash flows.
25. TRG members also observed that although the fact pattern in Agenda Paper 4 is limited in scope, it demonstrates the principle that both rights and obligations need to be considered when assessing the boundary of a contract.

***Determining the quantity of benefits for identifying coverage units (Agenda Paper 5)***

26. Agenda Paper 5 addresses a submission about the definition of 'quantity of benefits' in paragraph B119(a) of IFRS 17. This discussion is a continuation of the discussion from the February 2018 meeting of the TRG.
27. Paragraph B119 of IFRS 17 requires that 'An amount of the contractual service margin for a group of insurance contracts is recognised in profit or loss in each period to reflect the services provided under the group of insurance contracts in that period'.



28. Paragraph B119(a) of IFRS 17 requires an entity to determine the services provided by the group of insurance contracts ‘by considering for each contract the quantity of benefits provided under a contract and its expected coverage duration’.
29. Agenda Paper 5 considers:
- (a) insurance contracts without investment components; and
  - (b) insurance contracts with investment components.
30. One TRG member observed that some insurance contracts without investment components could have amounts payable on a claim that depend on asset returns.
31. Paragraphs 32–35 summarise the TRG discussions on the determination of coverage units to reflect the service provided under a group of contracts. Paragraphs 36–39 summarise the TRG discussions on whether the services provided include investment-related services.

*How to determine coverage units to reflect the services provided under a group of contracts*

32. TRG members discussed the analysis in Agenda Paper 5. They observed that IFRS 17 established a principle (to reflect the services provided in a period under a group of insurance contracts), not detailed requirements, and that it would not be possible to develop detailed requirements that would apply appropriately to the wide variety of insurance products existing globally.
33. TRG members also observed the determination of coverage units is not an accounting policy choice but involves judgement and estimates to best achieve the principle of reflecting the services provided in each period. Those judgements and estimates should be applied systematically and rationally.
34. TRG members noted the analysis of the examples in Agenda Paper 5 depends on the fact patterns in that paper, and would not necessarily apply to other fact patterns. In addition, which method would best reflect the services provided in each period would be a matter of judgement based on facts and circumstances.
35. In considering how to achieve the principle, TRG members observed:
- (a) the period in which an entity bears insurance risk is not necessarily the same as the insurance coverage period.

- (b) expectations of lapses of contracts are included in the determination of coverage units because they affect the expected duration of the coverage. Consistently, coverage units reflect the likelihood of insured events occurring to the extent that they affect the expected duration of coverage for contracts in the group.
- (c) because the objective is to reflect the insurance services provided in each period, different levels of service across periods should be reflected in the determination of coverage units.
- (d) determining the quantity of benefits provided under a contract requires an entity to consider the benefits expected to be received by the policyholder, not the costs of providing those benefits expected to be incurred by the entity.
- (e) a policyholder benefits from the entity standing ready to meet valid claims, not just from making a claim if an insured event occurs. The quantity of benefits provided therefore relates to the amounts that *can* be claimed by the policyholder.
- (f) different probabilities of an insured event occurring in different periods do not affect the benefit provided in those periods of the entity standing ready to meet valid claims for that insured event. Different probabilities of different types of insured events occurring might affect the benefit provided by the entity standing ready to meet valid claims for the different types of insured events.
- (g) IFRS 17 does not specify a particular method or methods to determine the quantity of benefits. Different methods may achieve the objective of reflecting the services provided in each period, depending on facts and circumstances.
- (h) The following methods might achieve the objective *if they are reasonable proxies for the services provided under the group of insurance contracts in each period*:
  - (i) a straight-line allocation over the passage of time, but reflecting the number of contracts in a group.

- (ii) a method based on the maximum contractual cover in each period.
- (iii) a method based on the amount the entity expects the policyholder to be able to validly claim in each period if an insured event occurs.
- (iv) methods based on premiums. However, premiums will not be reasonable proxies when comparing serviced across periods if they are receivable in different periods to those in which insurance serviced are provided, or reflect different probabilities of claims for the same type of insured event in different periods rather than different levels of service of standing ready to meet claims. Additionally, premiums will not be reasonable proxies when comparing contracts in a group if the premiums reflect different levels of profitability in contracts. The level of profitability in a contract does not affect the services provided by the contract.
- (v) methods based on expected cash flows. However, methods that result in no allocation of the contractual service margin to periods in which the entity is standing ready to meet valid claims do not meet the objective.

*Do the services provided by an insurance contract include investment-related services*

- 36. Agenda Paper 5 provided different analysis for insurance contracts with direct participation features (variable fee approach (VFA) contracts) and insurance contracts without direct participation features (general model contracts).
- 37. TRG members discussed the analysis in Agenda Paper 5 for VFA contracts and observed that:
  - (a) IFRS 17 identifies VFA contracts as contracts that provide both insurance services and investment-related services.
  - (b) the consequences of VFA contracts providing both insurance services and investment-related services is that:
    - (i) the references to services in paragraphs 45 and B119 of IFRS 17 relate to insurance and investment-related services;
    - (ii) the reference to quantity of benefits in paragraph B119(a) of IFRS 17 relates to insurance and investment-related benefits; and

(iii) the reference to expected coverage duration in paragraph B119(a) of IFRS 17 relates to duration of insurance and investment-related services.

38. TRG members expressed different views on whether it was necessary to clarify that the definition of coverage period for VFA contracts includes the period in which investment-related services are provided.
39. TRG members discussed the analysis in Agenda Paper 5 for general model contracts. Most TRG members disagreed that insurance contracts under the general model should be treated as providing only insurance services.

***Implementation challenges outreach report (Agenda Paper 6)***

40. Agenda Paper 6 reports on outreach performed by staff to obtain further details about implementation challenges TRG members raised at the February 2018 meeting of the TRG. The outreach relates to three submissions on the following topics that TRG members identified as causing implementation challenges because the requirements in IFRS 17 represent a significant change from existing practices:
- (a) presentation of groups of insurance contracts in the statement of financial position;
  - (b) premiums received applying the premium allocation approach (PAA); and
  - (c) subsequent treatment of insurance contracts acquired in their settlement period.
41. TRG members discussed Agenda Paper 6 and observed that:
- (a) Agenda Paper 6 accurately reflects the implementation challenges identified by TRG members about applying these requirements in IFRS 17.
  - (b) these challenges have been identified by TRG members as high priority in the implementation of IFRS 17 as they are significant in terms of complexity and cost. However, these are not the only significant challenges in implementing IFRS 17.
42. The topics in paragraph 40(a)–(b) of this paper relate to the level of aggregation in IFRS 17. On the level of aggregation in IFRS 17:

- (a) TRG members questioned the usefulness of the information that the presentation requirements in IFRS 17 will provide to the users of financial statements.
  - (b) some TRG members expressed the view that determining premiums received, the liability for incurred claims and other relevant items at a level that is higher than the group and allocating them to groups of insurance contracts based on reasonable and supportable information might not be appropriate. Others commented that the use of such allocation could raise challenges for auditors.
  - (c) a few TRG members suggested that the challenges raised by TRG members might also be relevant for reinsurers and other entities that operate on a net cash flow basis, such as the Lloyd's of London market.
43. On the subsequent treatment of insurance contracts acquired in their settlement period, paragraph 39 of Agenda Paper 6 describes some TRG members concerns that these contracts might not meet the criteria for the optional PAA because the coverage period is expected to be more than one year. TRG members highlighted that there are two different criterion for the PAA – paragraph 53(a) of IFRS 17 *or* paragraph 53(b) of IFRS 17. An entity can choose to apply the premium allocation approach for a group of insurance contracts when the coverage period of each contract in the group is longer than one year if those contracts meet the criteria in paragraph 53(a) of IFRS 17.
44. Agenda Paper 2C for the May 2018 Board meeting provided the Board with a copy of Agenda Paper 6 of the 2 May 2018 TRG meeting.

***Reporting on other questions submitted (Agenda Paper 7)***

45. Agenda Paper 7 considered submissions to the TRG that:
- (a) can be answered applying only the words in IFRS 17;
  - (b) do not meet the submission criteria; or
  - (c) are being considered through a process other than a TRG discussion (such as a proposed annual improvement).
46. TRG members made the following observations:

- (a) *S29 Discount rates used in the allocation of insurance finance income or expenses to profit or loss*

A few TRG members commented that using an effective yield rate compared to using a yield curve could result in a significant difference to the insurance finance income or expense to be included in profit or loss over the reporting periods subsequent to initial recognition.

- (b) *S33 Scope of IFRS 17*

One TRG member commented that entities that are not insurers may not be aware of the implications of IFRS 17 if they issue products that fall within the scope of IFRS 17. The staff are performing research in response to this implementation question.

- (c) *S13 Modifications to retrospective application*

Full retrospective transition to IFRS 17 is consistent with full retrospective transition to other IFRS Standards. The existence of specified modifications in the modified retrospective approach to transition does not preclude the use of estimates for either full retrospective transition or modified retrospective transition as usual in applying IFRS Standards.

### **Next steps**

47. The next meeting of the TRG will be held on 26 September 2018. Submissions of implementation questions received after 20 July 2018 are unlikely to be discussed at the meeting on 26 September.