

Summary of the Transition Resource Group for IFRS 17 *Insurance Contracts* meeting held on 26–27 September 2018

1. The Transition Resource Group for IFRS 17 *Insurance Contracts* (TRG) held its third meeting on 26–27 September 2018 at the London office of the IFRS Foundation. These notes summarise the discussions.
2. Agenda Paper 2A for the October 2018 meeting of the International Accounting Standards Board (Board) provides the Board with a copy of this summary.
3. The discussions at the TRG meetings are based on 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 and share their views on the accounting analysis. Some agenda papers include specific fact patterns. The analysis in an agenda paper may be relevant to other fact patterns but all the specific facts and circumstances of those fact patterns need to be evaluated when applying IFRS 17.
4. TRG members discussed the following 10 topics:
 - (a) insurance risk consequent to an incurred claim;
 - (b) determining discount rates using a top-down approach;
 - (c) commissions and reinstatement premiums in reinsurance contracts issued;
 - (d) premium experience adjustments related to current or past service;
 - (e) cash flows that are outside the contract boundary at initial recognition;
 - (f) recovery of insurance acquisition cash flows;
 - (g) premium waivers;
 - (h) group insurance policies;
 - (i) industry pools managed by an association; and
 - (j) annual cohorts for contracts that share in the return of a specified pool of underlying items.

5. TRG members received a report on other questions submitted.

Insurance risk consequent to an incurred claim (Agenda Paper 1)

6. Agenda Paper 1 addresses submissions about a situation in which an incurred claim under an insurance contract creates insurance risk for the entity that would not exist if no claim were made.
7. The submissions ask whether the entity's obligation to pay amounts subject to insurance risk after an incurred claim should be treated as:
 - (a) a liability for incurred claims; or
 - (b) a liability for remaining coverage.
8. The paper uses two examples to illustrate alternative applications of the relevant definitions in IFRS 17:
 - (a) insurance coverage for disability that provides an annuity for the period in which the policyholder is disabled; and
 - (b) insurance coverage for fire that provides compensation for the cost of rebuilding a house after a fire.
9. TRG members discussed the analysis in Agenda Paper 1 and observed that:
 - (a) the classification of an obligation as a liability for incurred claims or a liability for remaining coverage does not affect the determination of the fulfilment cash flows. However, the classification does affect the determination of the coverage period. Consequently, the classification affects whether some changes in the fulfilment cash flows adjust the contractual service margin and the allocation of the contractual service margin.
 - (b) the definitions of IFRS 17 allow an entity to use judgement when determining whether the obligation to pay an annuity after a disability event and the obligation to pay the costs of rebuilding a house after a fire event are part of a liability for remaining coverage or a liability for incurred claims.

- (c) thus, it is a matter of judgement for an entity to develop an accounting policy that reflects the insurance service provided by the entity to the policyholder under the contract in accordance with IFRS 17. The requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* apply. Hence, the entity should apply an approach consistently for similar transactions and over time.
- (d) whichever approach an entity applies, IFRS 17 requires disclosure of significant judgements made in applying the Standard and requires disclosures relating to the contractual service margin, which will enable users to understand the effects of the approach applied.
- (e) these observations are also relevant when law or regulation impose a requirement for an entity to settle a claim by life-contingent annuity payments.

Determining discount rates using a top-down approach (Agenda Paper 2)

- 10. Agenda Paper 2 addresses submissions about how an entity applies a top-down approach to determine the discount rates for insurance contracts with cash flows that do not vary based on the returns of underlying items. The submissions question whether:
 - (a) an entity could use the assets it holds as a reference portfolio of assets;
 - (b) an entity could ignore the liquidity characteristics of insurance contracts; and
 - (c) changes in the assets the entity holds result in changes in the discount rates used to measure insurance contracts under specific circumstances.
- 11. TRG members discussed the analysis in Agenda Paper 2 and observed that:
 - (a) IFRS 17 does not specify restrictions on the reference portfolio of assets used in applying a top-down approach to determine discount rates. Also, IFRS 17 does not define ‘a reference portfolio of assets’. Consequently, a portfolio of assets that an entity holds can be used as a reference portfolio of assets to determine the discount rates as stated in paragraph B81 of IFRS 17, provided

that the discount rates achieve the following objectives set out in paragraph 36 of IFRS 17:

- (i) reflecting the characteristics of the insurance contracts; and
 - (ii) being consistent with observable current market prices.
- (b) as an overall principle, paragraph 36 of IFRS 17 requires that discount rates reflect, among other factors, the liquidity characteristics of the insurance contracts. However, when using the top-down approach, as a simplification, paragraph B81 of IFRS 17 permits an entity not to adjust the yield curve derived from a reference portfolio of assets for differences in liquidity characteristics of the insurance contracts and the reference portfolio. The Board expected a reference portfolio of assets typically to have liquidity characteristics closer to the liquidity characteristics for a group of insurance contracts than would be the case for highly liquid, high-quality bonds as reflected in the Basis for Conclusions on IFRS 17.
- (c) in applying paragraph 36 of IFRS 17 to determine the appropriate discount rates for cash flows that do not vary based on the returns on underlying items, an entity ensures that at each reporting date those discount rates reflect the characteristics of the insurance contracts, even when the entity chooses to use a portfolio of assets that it holds to determine the discount rates.
- (d) to achieve the objectives in paragraph 36 of IFRS 17 an entity needs to make adjustments to the yield curve of the reference portfolio of assets at each reporting date to eliminate any effect on discount rates of credit risk and differences in liquidity characteristics of the insurance contracts and the reference portfolio. However, if the entity uses the simplification related to liquidity, fluctuations in the liquidity of the reference portfolio are mirrored in the changes in the discount rates used to measure the group of insurance contracts.

12. TRG members also observed that, when an entity uses the simplification related to liquidity, small changes in discount rates that result from changes in the composition of the reference portfolio or the liquidity characteristics of the reference portfolio could result in significant changes to the insurance contract liabilities measured using those rates, particularly with respect to long-term insurance contracts. The following disclosure requirements of IFRS 17 are particularly helpful in these circumstances for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows:
- (a) the methods used to determine discount rates and the processes for estimating the inputs to those methods, including the identification of a reference portfolio, the adjustments to the yield curve to determine the discount rates and the use of the simplification mentioned in paragraph B81 of IFRS 17; and
 - (b) the effect of a change in the composition of the assets in the reference portfolio on discount rates used to measure insurance contracts, if material.

Commissions and reinstatement premiums in reinsurance contracts issued (Agenda Paper 3)

13. Agenda Paper 3 addresses submissions about amounts exchanged between the issuer of a reinsurance contract (the reinsurer) and the holder of a reinsurance contract (the cedant). The submissions question how the following features should be accounted for in the financial statements of the reinsurer:
- (a) common types of commissions due to the cedant; and
 - (b) reinstatement premiums charged to the cedant following the occurrence of an insured event.
14. TRG members discussed the analysis in Agenda Paper 3 and observed that:
- (a) the requirements set out in paragraph 86 of IFRS 17 for the presentation of income or expenses from reinsurance contracts held are based on the economic effect of exchanges between the reinsurer and the cedant, and it would be appropriate to apply an assessment of the economic effect of such exchanges to reinsurance contracts issued as well.

- (b) the economic effect of amounts exchanged between a reinsurer and a cedant that are not contingent on claims is equivalent to the effect of charging a different premium. Therefore, those amounts would be recognised as part of insurance revenue applying paragraph B123 or B126 of IFRS 17.
 - (c) the economic effect of amounts exchanged between a reinsurer and a cedant that are contingent on claims is equivalent to reimbursing a different amount of claims than expected. Therefore, those amounts would be recognised as part of insurance service expenses applying paragraph 42(a) of IFRS 17.
 - (d) unless the cedant provides a distinct service to the reinsurer that results in a cost to the reinsurer for selling, underwriting and starting a group of reinsurance contracts that it issues, a ceding commission is not an insurance acquisition cash flow of the reinsurer.
 - (e) amounts exchanged between the reinsurer and the cedant that are not contingent on claims may meet the definition of an investment component if they are repaid to the cedant in all circumstances (including on cancellation of the contract).
15. Some TRG members also observed that applying the requirements in IFRS 17 for amounts exchanged between a reinsurer and a cedant has practical implications because the requirements are different from existing practice. TRG members also observed that applying the requirements of IFRS 17 may affect some key performance measures currently used to assess the performance of reinsurers.

Premium experience adjustments related to current or past service (Agenda Paper 4)

16. Agenda Paper 4 addresses submissions about how differences between expected premiums and actual premiums (ie premium experience adjustments) which relate to current or past service should be accounted for. Should those differences:
- (a) adjust the contractual service margin; or
 - (b) be recognised in the statement of profit or loss immediately as part of either:

- (i) insurance revenue; or
- (ii) insurance service expenses?

17. TRG members discussed the analysis in Agenda Paper 4 and observed that:

- (a) applying the general model, experience adjustments arising from premiums received in the period that relate to future service adjust the contractual service margin according to paragraph B96(a) of IFRS 17. Premium experience adjustments related to current or past service should be recognised immediately in the statement of profit or loss as part of insurance revenue applying paragraphs B120 and B123 of IFRS 17.
- (b) the purpose of paragraph B124 of IFRS 17 is to demonstrate an alternative analysis of insurance revenue as determined by paragraph B123 of IFRS 17. Hence, applying the requirements in IFRS 17 should result in premium experience adjustments relating to current and past service being included in insurance revenue despite the lack of a specific reference to them in paragraph B124 of IFRS 17.
- (c) for the premium allocation approach, the requirements in paragraph B126 of IFRS 17 apply to expected premium receipts, including premium experience adjustments.

18. TRG members also observed that:

- (a) given that an entity is required by paragraph 106 of IFRS 17 to disclose an analysis of the insurance revenue recognised in the period, an additional line item may be necessary in the reconciliation to reflect the effect of premium experience adjustments on the revenue recognised in the period.
- (b) in some circumstances, judgement may be required to determine whether premium experience adjustments relate to future service and, therefore, adjust the contractual service margin applying paragraph B96(a) of IFRS 17.

Cash flows that are outside the contract boundary at initial recognition (Agenda Paper 5)

19. Agenda Paper 5 addresses submissions about how to account for cash flows that, at initial recognition, are outside the boundary of the contract when facts or circumstances change over time. The paper addresses both an insurance contract issued and a reinsurance contract held.
20. TRG members discussed the analysis in Agenda Paper 5 and observed that:
 - (a) the requirements in paragraphs 35 and B64 of IFRS 17 are different because they address different circumstances.
 - (b) paragraph 35 of IFRS 17 applies to cash flows that are outside the boundary of a contract and that relate to future contracts. When paragraph 35 of IFRS 17 applies, additional cash flows will be recognised as a new contract when the recognition criteria of a new group of contracts are met.
 - (c) paragraph B64 of IFRS 17 discusses the assessment of the practical ability of an entity to reprice a contract considering constraints that might limit that ability and, therefore, applies to the reassessment of the contract boundary in this context. When paragraph B64 of IFRS 17 applies, the fulfilment cash flows are updated to reflect changes in cash flows that are within the (revised) contract boundary. When such changes relate to future service they are recognised by adjusting the carrying amount of the contractual service margin of the group of contracts to which the contract belongs.
21. TRG members expressed different views as to the applicability of the distinction between paragraphs 35 and B64 of IFRS 17 in circumstances where cash flows that are outside the contract boundary at initial recognition relate to an additional type of coverage that may be provided over the coverage period of the contract.

Recovery of insurance acquisition cash flows (Agenda Paper 6)

22. Agenda Paper 6 addresses a submission about whether insurance acquisition cash flows and the related revenue are recognised in the statement of profit or loss, applying paragraph B125 of IFRS 17, if those cash flows cannot be recovered from

the cash flows of the portfolio of contracts. Agenda Paper 6 also addresses the accounting for changes in insurance acquisition cash flows applying paragraphs B123 and B125 of IFRS 17.

23. TRG members discussed the analysis in Agenda Paper 6 and observed that:
- (a) paragraphs B123 and B125 of IFRS 17 work together to achieve an insurance revenue that reflects the total premium (adjusted for a financing effect and excluding any investment component), as required by paragraph B120 of IFRS 17. An entity is not required separately to identify whether it will recover insurance acquisition cash flows at each reporting date.
 - (b) paragraph B125 of IFRS 17 assumes that the portion of premiums relating to the recovery of insurance acquisition cash flows is equal to the current estimate of total expected insurance acquisition cash flows at each reporting period.
24. TRG members also noted that experience adjustments arising from premiums received in the period that relate to future service, and the related cash flows such as insurance acquisition cash flows, adjust the contractual service margin applying paragraph B96(a) of IFRS 17.

Premium waivers (Agenda Paper 7)

25. Agenda Paper 7 addresses a submission about whether terms in an insurance contract that waive premiums in specified circumstances create insurance risk. An example of such a waiver is one that allows a policyholder to avoid paying premiums in specified circumstances, for example, if the policyholder has been disabled for six consecutive months. The policyholder continues to receive the benefits originally promised under the insurance contract despite the waiver of premiums.
26. The submission asks whether the risk related to the premium waiver is a pre-existing risk of the policyholder transferred to the entity by the contract and is, therefore, an insurance risk, or a new risk created by the contract.
27. TRG members discussed the analysis in Agenda Paper 7 and observed that:

- (a) there is an insurance risk when an entity provides a waiver of premiums if a specified event occurs;
- (b) a waiver of premiums differs from situations discussed in paragraphs B21(a)–(b) of IFRS 17; and
- (c) the consequences of a waiver of premiums are:
 - (i) the inclusion of such a waiver in an investment contract makes the investment contract an insurance contract; and
 - (ii) the inclusion of such a waiver in a contract that would be an insurance contract without the waiver may affect the quantity of benefits provided by the contract and the coverage period, both of which could affect the recognition of the contractual service margin in profit or loss. The recognition of the contractual service margin was discussed in Agenda Paper 5 of the February 2018 TRG meeting and Agenda Paper 5 of the May 2018 TRG meeting.

Group insurance policies (Agenda Paper 8)

- 28. Agenda Paper 8 addresses a submission about the boundary of a contract for an arrangement between an entity and an association or a bank (referred to as a ‘group insurance policy’) under which the entity provides insurance coverage to members of an association or to customers of a bank (referred to as ‘certificate holders’).
- 29. TRG members discussed the analysis in Agenda Paper 8 and observed that:
 - (a) for group insurance policies, an entity should consider whether the policyholder is the association or bank, or the certificate holders. IFRS 17 defines a policyholder by its right to compensation if it is adversely affected by an insured event. This is the case regardless of whether that compensation is received directly or indirectly by paying amounts on the policyholder’s behalf.
 - (b) for group insurance policies, an entity should consider whether the arrangement reflects a single insurance contract or multiple insurance contracts (ie with each certificate holder). Rebutting the presumption that the

contract is a single contract by separating components involves judgement and careful consideration of all facts and circumstances.¹

- (c) for the group insurance policies described in the submission, the following facts and circumstances are indicative that the arrangement reflects multiple insurance contracts (ie an insurance contract with each certificate holder) for the purpose of applying IFRS 17:
 - (i) the insurance coverage is priced and sold separately;
 - (ii) other than being members of the association or customers of the bank the individuals are not related to one another; and
 - (iii) purchasing the insurance coverage is an option for each individual.
- (d) an entity should assess the boundary of each insurance contract. For the group insurance policies described in the submission, the entity's substantive obligation to provide services under a contract ends at the point that the entity can terminate the contract. The certificate holder's expectation that the group insurance policy will not be terminated earlier than the end of the contract term is not relevant to the assessment of the contract boundary applying paragraph 34 of IFRS 17.

30. TRG members noted the specific fact pattern discussed in Agenda Paper 8 and that the analysis relates to that fact pattern. TRG members observed that in practice there are many group insurance policies with different terms. The assessment of whether a group insurance policy arrangement reflects a single insurance contract or multiple insurance contracts should be applied to group insurance policies considering all relevant facts and circumstances.

¹ Separation of insurance components of a single insurance contract was discussed at the February 2018 TRG meeting.

Industry pools managed by an association (Agenda Paper 9)

31. Agenda Paper 9 addresses a submission about the level at which the risk adjustment for non-financial risk should be determined for insurance contracts that are within industry pools managed by an association.
32. The submission asks whether, for insurance contracts that are within either of the two industry pools described in the submission, the risk adjustment for non-financial risk should be determined at either:
 - (a) the association level; or
 - (b) the individual member entity level.
33. TRG members discussed the analysis in Agenda Paper 9 and observed that:
 - (a) in some cases, the parties to the contract are clear from the legal form of the contract. In other cases, the terms of the contract require analysis to identify the substance of the rights and obligations—including who is the issuer of the contract. For insurance contracts in an industry pool the issuer could be:
 - (i) the individual member entity that writes the contracts;
 - (ii) each member entity for its respective share of each contract in the pool;
or
 - (iii) the collective comprised of all member entities.
 - (b) IFRS 17 applies to insurance contracts issued by an entity and does not have specific requirements for insurance contracts issued by more than one entity. Entities should assess whether an arrangement under which an insurance contract is issued by more than one entity is also within the scope of another IFRS Standard, for example IFRS 11 *Joint Arrangements*. IAS 8 includes requirements for an entity to apply in the absence of a Standard that specifically applies to a transaction, other event or condition.

- (c) in some cases, an individual member entity may write an insurance contract and then subsequently transfer the contract to the industry pool. If that member entity is the issuer of the contract applying IFRS 17, the entity should consider whether the transfer:
 - (i) is a contract that meets the definition of a reinsurance contract applying IFRS 17; or
 - (ii) extinguishes the individual member's obligations to the policyholder applying paragraph 74 of IFRS 17.
- 34. TRG members noted the specific fact pattern discussed in Agenda Paper 9 and observed that the assessment of identifying the issuer of insurance contracts within an industry pool arrangement and the accounting for an insurance contract that is issued by more than one entity should be applied consistently to similar arrangements considering all relevant facts and circumstances.
- 35. In relation to the risk adjustment for non-financial risk, TRG members observed that paragraph B88 of IFRS 17 requires the risk adjustment for non-financial risk to reflect the degree of diversification benefit included in the compensation required for bearing non-financial risk.
- 36. The analysis in Agenda Paper 9 distinguished between contracts issued by an individual member entity of an industry pool and contracts issued by the collective comprised of all members. In the former case, the risk adjustment for non-financial risk is determined by individual member entity. In the latter case it is determined by the collective. Some TRG members expressed the view that applying paragraph B88 of IFRS 17, each entity would consider the compensation it would require for bearing the non-financial risk, rather than the compensation required by the association. This is consistent with their differing views as to whether for a group of insurance contracts the risk adjustment for non-financial risk at the consolidated group level could differ from the risk adjustment for non-financial risk at the individual issuing entity level (see summary of the TRG meeting held on 2 May 2018 on determining the risk adjustment for non-financial risk in a group of entities).

Annual cohorts for contracts that share in the return of a specified pool of underlying items (Agenda Paper 10)

37. Agenda Paper 10 addresses a submission about annual groups of contracts with policyholders that all share in the return on a specified pool of underlying items, with some of the return contractually passing from one group of policyholders to another.
38. The submission notes that paragraph BC138 of the Basis for Conclusions on IFRS 17 explains:
- ... the requirements specify the amounts to be reported, not the methodology to be used to arrive at those amounts. Therefore, it may not be necessary for an entity to restrict groups in this way to achieve the same accounting outcome in some circumstances.
39. The submission asks in what circumstances measuring the contractual service margin at a higher level than an annual cohort level, such as a portfolio level, would achieve the same accounting outcome as measuring the contractual service margin at an annual cohort level applying paragraph 22 of IFRS 17.
40. TRG members discussed the analysis in Agenda Paper 10 and observed that:
- (a) paragraph BC138 of the Basis for Conclusions on IFRS 17 explains the effect of the requirements of IFRS 17 and does not change those requirements.
 - (b) when a specified pool of underlying items consists of the insurance contracts issued to the policyholders that share in the returns of that pool, the criteria in paragraph B67 of IFRS 17 are met regardless of whether the policyholders share in 100% of the return on the pool of underlying items or only part of the return on the pool of underlying items.
 - (c) for contracts that share in 100% of the return on a pool of underlying items consisting of the insurance contracts, the contractual service margin will be nil. Therefore, measuring the contractual service margin at a higher level than the annual cohort level, such as a portfolio level, would achieve the same accounting outcome as measuring the contractual service margin at an annual cohort level applying IFRS 17.

(d) when contracts share to a lesser extent in the return on a pool of underlying items consisting of the insurance contracts, an entity could be affected by the expected cash flows of each contract issued. Therefore, the contractual service margin of the groups of contracts may differ from the contractual service margin measured at a higher level, such as the portfolio level. To assess whether measuring the contractual service margin at a higher level would achieve the same accounting outcome as measuring the contractual service margin at an annual cohort level, an entity would need to determine what the effect would be of applying the requirements in IFRS 17. To be able to measure the contractual service margin at a higher level, the accounting outcome would need to be the same in all circumstances, ie regardless of how assumptions and experience develop over the life of the contract.

41. TRG members also observed that the examples in Agenda Paper 10 were not representative of many situations in practice. TRG members observed that in practice, cash flows would be determined at a higher level than in the examples, and that paragraph B70 of IFRS 17 would apply for allocating cash flows to the groups. Therefore, there may be some situations where the same accounting outcome is achieved using annual cohorts or a higher level of aggregation when applying the requirements of IFRS 17 to contracts that share 90% in the returns on a pool of underlying items consisting of the insurance contracts.

Reporting on other questions submitted (Agenda Paper 11)

42. Agenda Paper 11 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.

43. TRG members made the following observations:

(a) *S56 and S67 Reporting frequency*

TRG members noted the requirements in paragraph B137 of IFRS 17. However, some TRG members expressed concerns over the operational complexity involved with applying these requirements.

(b) *S33 Scope of IFRS 17*

Some TRG members expressed concerns that when applying IFRS 17 an entity might be required to account for loans and other forms of credit that include a relatively small insurance component entirely as insurance contracts.

Next steps

44. The next meeting of the TRG is currently scheduled to be held on 4 December 2018. Submissions of implementation questions received after 26 October 2018 are unlikely to be discussed at the meeting on 4 December 2018. Given the timing of the September 2018 TRG meeting relative to the December 2018 TRG meeting and depending on the number and the nature of the submissions that are received for the December 2018 TRG meeting, an assessment will be made as to whether to postpone the December 2018 TRG meeting to early 2019.