Summary of the Transition Resource Group for IFRS 17 *Insurance Contracts* meeting held on 6 February 2018

1. The Transition Resource Group for IFRS 17 *Insurance Contracts* (TRG) held a meeting on 6 February 2018 at the London office of the IFRS Foundation. These notes summarise the discussions.

2. Agenda Paper 2A for the February 2018 meeting of the International Accounting Standards Board (Board) updated the Board on the TRG meeting held on 6 February 2018 and provided a copy of this summary.

3. The discussions of the TRG are based on the agenda papers which provide an accounting analysis of the implementation questions submitted to the TRG. These agenda papers provide a basis for the TRG members to understand the implementation questions raised and share their views on the accounting analysis as industry experts directly involved in IFRS 17 implementation. The staff note that although the analysis in an agenda paper may be relevant to other fact patterns, all relevant facts and circumstances of a particular fact pattern would need to be evaluated when applying IFRS 17 in practice.

4. The TRG discussed the following topics:

    (a) separation of insurance components of a single insurance contract;

    (b) boundary of contracts with annual repricing mechanisms;

    (c) boundary of reinsurance contracts held;

    (d) insurance acquisition cash flows paid and future renewals;

    (e) determining the quantity of benefits for identifying coverage units; and

    (f) insurance acquisition cash flows when using fair value transition.

5. The TRG was provided with a report on other questions submitted.

Separation of insurance components of a single insurance contract (Agenda Paper 1)

6. Sometimes entities combine different types of coverage that have different risks into one legal insurance contract. Similarly, reinsurance contracts held can provide coverage to

underlying contracts that are included in different groups of insurance contracts. Agenda Paper 1[1] addresses two submissions received about whether:

(a) IFRS 17 permits the separation of insurance components of a single insurance contract for measurement purposes.

(b) when applying IFRS 17, a reinsurance contract held should be separated into components for measurement purposes to reflect the underlying contracts covered. For example, whether a reinsurance contract held that provides coverage to underlying contracts that are included in different groups of insurance contracts should be separated.

7. TRG members discussed the analysis in Agenda Paper 1 and observed that:

(a) the lowest unit of account that is used in IFRS 17 is the contract that includes all insurance components.

(b) entities would usually design contracts in a way that reflects their substance. Therefore a contract with the legal form of a single contract would generally be considered a single contract in substance. However:

(i) there might be circumstances where the legal form of a single contract would not reflect the substance of its contractual rights and obligations.

(ii) overriding the contract unit of account presumption by separating insurance components of a single insurance contract involves significant judgement and careful consideration of all relevant facts and circumstances. It is not an accounting policy choice.

(c) combining different types of products or coverages that have different risks into one legal insurance contract is not, in itself, sufficient to conclude that the legal form of the contract does not reflect the substance of its contractual rights and obligations. Similarly, the availability of information to separate cash flows for different risks is not, in itself, sufficient to conclude that the contract does not reflect the substance of its contractual rights and obligations.

[1] All references to agenda papers in this meeting summary refer to the agenda papers for the TRG meeting on 6 February 2018 unless stated otherwise.

(d) the fact that a reinsurance contract held provides cover for underlying contracts that are included in different groups is not, in itself, sufficient to conclude that accounting for the reinsurance contract held as a single contract does not reflect the substance of its contractual rights and obligations.

8. TRG members also observed that:

(a) considerations that might be relevant in the assessment of whether the legal form of a single contract reflects the substance of its contractual rights and contractual obligations include:

(i) interdependency between the different risks covered;

(ii) whether components lapse together; and

(iii) whether components can be priced and sold separately.

(b) an example of when it may be appropriate to override the presumption that a single legal contract is the lowest unit of account is when more than one type of insurance cover is included in one legal contract solely for the administrative convenience of the policyholder and the price is simply the aggregate of the standalone prices for the different insurance covers provided.

(c) Appendix A to Agenda Paper 1 provides specified fact pattern of a contract containing a long term life coverage with annual renewable health riders. At each annual renewal date the entity can reassess the risks and can set a price that fully reflects these risks with respect to the renewable health rides, but cannot reprice or cancel the life coverage of the contract. The following factors indicate its substance as a single contract:

(i) the renewable health riders are not sold separately;

(ii) if the life coverage is cancelled by the policyholder, the renewable riders are cancelled at the same time; and

(iii) the renewable riders are rarely cancelled and most of them remain until the end of the coverage period of the life contract.

Therefore, in relation to the example in Appendix A to Agenda Paper 1:

(i) the contract is included in its entirety in a single portfolio and in a single group and is not split to reflect the ways its components would be allocated to portfolios and groups as if there were issued as separate contracts.

(ii) the cash flows within the boundary of the contract would be assessed for the contract in its entirety. The assessment of when a substantive obligation to provide the policyholder with services ends will be performed for the contract in its entirety. Therefore, in this example, cash flows related to the premiums within the contract boundaries include cash flows related to the renewable health riders beyond the annual re-pricing date.

(iii) the contract would be evaluated against the criteria for applying the premium allocation approach in its entirety.

Boundary of contracts with annual repricing mechanisms (Agenda Paper 2)

9. Agenda Paper 2 addresses a submission received about whether insurance contracts with annual repricing mechanisms would have a contract boundary of one year or longer than one year—ie whether the cash flows used to measure those contracts would be only those related to premiums up to their annual re-pricing date because the cash flows related to premiums after that date would relate to future contracts.

10. The submission describes specified fact patterns of two insurance contracts. In these fact patterns, risk is assessed at a portfolio of insurance contracts level rather than an individual contract level, and therefore paragraph 34(a) of IFRS 17 is not applicable. The contract boundary is instead determined based on the assessment of risk applying paragraph 34(b) of IFRS 17.

11. TRG members discussed the analysis in Agenda Paper 2 and noted that:

(a) paragraph 34(a) of IFRS 17 refers to the practical ability to reassess the risks of the policyholder (ie policyholder risk). Paragraph 34(b) of IFRS 17 should be read as an extension of the risk assessment in paragraph 34(a) from the individual to portfolio level, without extending policyholder risks to all types of risks and considerations applied by an entity when pricing a contract. The staff noted that policyholder risk includes both the insurance risk and the financial risk transferred from the policyholder to the entity and therefore excludes lapse risk and expense risk.

(b) the specified fact patterns of the two contracts described in the submission have been understood in different ways.

(c) for the specified fact patterns of the two contracts described in the submission, the conclusion in the paper is that an entity can reset the premiums of the portfolios to which both of the example contracts belong annually to reflect the reassessed risk of those portfolios. The entity has the practical ability to reassess the risks of the specific portfolio of insurance contracts that contains the contract and, as a result, can set a price that fully reflects the risk of that portfolio and therefore meets the requirements of paragraph 34(b)(i) of IFRS 17. In the fact pattern presented, premiums increase in line with age each year based on the step-rated table—ie the contract does not charge level premiums, consequently the staff analysis assumes that the requirements in paragraph 34(b)(ii) of IFRS 17 are also met. Accordingly, for those two contracts, the cash flows resulting from the renewal terms should not be included within the boundary of the existing insurance contract.

(d) if, conversely, the fact patterns of the two contracts described in the submission was varied such that the entity instead has a practical ability to reassess risks only at a general level (for example, for a general community) and, as a result, can set a price for the portfolio of insurance contracts that contains the contract (for example, using a generic step-rate table) then this would provide the individual policyholders within the portfolios with a substantive right and consequently, the cash flows resulting from these renewal terms should be included within the boundary of the existing contract.

12. It was observed that in practice, unlike the fact pattern presented in Agenda Paper 2, some entities use a step-rated premium table for pricing that averages out the pricing between the different levels on the table (ie between the different steps). All relevant facts and circumstances would need to be considered for this fact pattern in assessing whether the requirements in paragraph 34(b)(ii) of IFRS 17 are met.

13. TRG members also observed that the two examples described in Agenda Paper 2 are for specific fact patterns. In practice, the features of contracts and their repricing might be different from those examples. The facts and circumstance of each contract should be assessed to reach an appropriate conclusion applying the requirements of IFRS 17.

Boundary of reinsurance contracts held (Agenda Paper 3)

14. Agenda Paper 3 addresses a submission received about how to read paragraph 34 of IFRS 17 regarding the boundary of an insurance contract with respect to reinsurance contracts held.

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

    (a) the application of the requirements in paragraph 34 of IFRS 17 to reinsurance contracts held means that cash flows within the boundary of a reinsurance contract held arise from the substantive rights and obligations of the entity—ie the holder of the contract, therefore:

        (i) the substantive right is to receive services from the reinsurer; and

        (ii) the substantive obligation is to pay amounts to the reinsurer.

    (b) a substantive right to receive services from the reinsurer ends when the reinsurer has the practical ability to reassess the risks transferred to the reinsurer and can set a price or level of benefits for the contract to fully reflect the reassessed risk or the reinsurer has a substantive right to terminate the coverage.

    (c) accordingly, the boundary of a reinsurance contract held could include cash flows from underlying contracts covered by the reinsurance contract that are expected to be issued in the future.

16. TRG members also observed that:

    (a) for some reinsurance contracts, the reinsurer can terminate the coverage at any time with a three month notice period. In these circumstances, the contract boundary would exclude cash flows related to premiums outside of that three month notice periods.

    (b) there is operational complexity involved in applying paragraph 34 of IFRS 17 to reinsurance contracts held because it is a change from existing practice. Those existing accounting practices for reinsurance contracts held generally:

        (i) do not require cash flows related to future underlying insurance contracts to be estimated; and

        (ii) net the effect in profit or loss of holding reinsurance in accounting for the insurance contract.

    A Board member observed that those existing accounting practices are inconsistent with accounting for reinsurance contracts held separately to the

underlying insurance contracts and using measurement principles for reinsurance contracts held that are consistent with the measurement of the insurance contracts issued.

17. Some TRG members questioned the interaction between paragraphs 34 and 62(a) of IFRS 17. The staff noted that paragraph 62(a) of IFRS 17 is a recognition requirement for reinsurance contracts held that provide proportionate coverage, and is not a measurement requirement.

Insurance acquisition cash flows paid on an initially written contract (Agenda Paper 4)

18. Agenda Paper 4 addresses a submission received about how to account for insurance acquisition cash flows unconditionally paid when a contract is initially written (ie it is not refundable), the entity expects renewals outside of the contract boundary to occur and has written new business with that expectation. The submission provides a specific fact pattern for the question raised and this is considered in the accounting analysis.

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

(a) insurance acquisition cash flows included in the measurement of a group are those that are directly attributable to the portfolio of insurance contracts to which the group belongs. Such cash flows include cash flows that are not directly attributable to individual contracts or groups of insurance contracts within the portfolio.

(b) insurance acquisition cash flows directly attributable to the portfolio, but not necessarily directly attributable to individual contracts (or a group), will need to be allocated in an appropriate manner to the groups within the portfolio. An entity shall use reasonable and supportable information to do so.

(c) acquisition cash flows that are directly attributable to individual contracts (or a group) should be included only in the measurement of the group to which the individual contracts belong (or of that group) and not to other groups within the same portfolio.

(d) the requirements of IFRS 17, for example paragraph 27, require acquisition costs paid or received that are directly attributable to future contracts to be recognised as an asset or liability before the group to which those future contracts belong is

recognised. Those acquisition costs include those that were paid or received before those contracts are issued. The TRG members also noted that the reference to ‘a group of issued insurance contracts’ in paragraph 27 of IFRS 17 is not intended to exclude insurance acquisition ash flows relating to contracts that have not yet been issued. It is intended to distinguish a group of insurance contracts issued from a group of reinsurance contracts held.

(e) in the specific fact pattern, the specified commission is paid unconditionally on the initially written contract (ie it is not refundable). Therefore, applying IFRS 17 requirements, it cannot be allocated to future groups and accordingly the specified commission is included in the measurement of the group to which the initially issued contract belongs.

(f) in the specified fact pattern provided in Agenda Paper 4, the initial contracts cannot be in the same group as contracts that are renewed during the same annual period applying the level of aggregation requirements. In this fact pattern the initial contracts are onerous contracts at initial recognition because, considering (e) above and allocating the acquisition cash flows to the initial group, the acquisition cash outflows are greater than the cash inflows included in the contract boundary. The renewed contracts belong to a different group because those contracts are not onerous at initial recognition.

20. Some TRG members observed that in existing practice an entity would not consider the specified insurance acquisition cash flows in the determination of whether the initially written insurance contracts are onerous. Consequently, the requirements in IFRS 17 represent a change to existing practice which entities need to be aware for their implementation strategy.

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

21. Coverage units establish the amount of the contractual service margin to be recognised in profit or loss for services provided in a period. Agenda Paper 5 addresses a submission received about how to determine the coverage units of a group of insurance contracts with no investment component. Insurance contracts with investment components will be discussed at a later meeting.

22. TRG members discussed the analysis in Agenda Paper 5 and observed that:

(a) coverage units reflect the likelihood of insured events occurring only to the extent that they affect the expected duration of contracts in the group; and

(b) coverage units do not reflect the likelihood of insurance events occurring to the extent that they affect the amount expected to be claimed in the period.

23. TRG members discussed the extent to which the determination of coverage units should reflect variability across periods in the level of cover provided by contracts in the group based on the narrow scope fact patterns presented. However, they observed that a view could not be reached before they also considered a wider scope including insurance contracts with investment components. Accordingly, the staff will bring a paper to a later TRG meeting that will address the determination of coverage units for contracts with investment components and will also develop further:

(a) the use of the maximum level of cover and the expected level of cover in periods. For example, the TRG considered a contract that provides cover for fire damage up to CU50m per year on a five year construction project. The value of the property covered is expected to increase over the 5 years. The maximum level of cover is the contract CU50m limit. The expected level of cover is the increasing value on which the entity is exposed to insurance risk.

(b) the balance to be struck between high-level principles and specific guidance, given the wide variety of insurance products that need to be considered.

24. TRG members agreed to send in their comments on the examples in Agenda Paper 5 by the end of February to help the development of the next paper.

Insurance acquisition cash flows when using fair value measurement on transition (Agenda Paper 6)

25. Agenda Paper 6 addresses a submission about whether, when the fair value approach to transition is applied in accordance with IFRS 17, insurance acquisition cash flows that occurred prior to the transition date are recognised as revenue and expenses in the statement of financial performance applying paragraphs B121(b) and B125 of IFRS 17 for reporting periods subsequent to the transition date.

26. TRG members discussed the analysis in Agenda Paper 6 and noted that:

(a) applying the fair value transition approach on transition, the amount of insurance acquisition cash flows included in the measurement of the contractual service

margin will only be the amount occurring after the transition date that is also included in the fulfilment cash flows. When this approach to transition is applied the entity is not required nor permitted to include in the measurement of the contractual service margin any insurance acquisition cash flows occurring prior to the date of transition.

(b) the fair value approach is intended to provide an entity with a 'fresh start' approach to transition.

(c) since insurance acquisition cash flows that occurred prior to the transition date are not included in the measurement of the contractual service margin at the transition date, they are not included in presentation of insurance revenue and expenses for reporting periods subsequent to the transition date.

27. The staff noted that the analysis in the paragraph above is applicable in all situations that the fair value transition approach is taken, irrespective of whether the entity can identify and measure the insurance acquisition cash flows that occurred prior to the transition date.

28. Separately, the staff noted that applying the modified retrospective approach to transition, paragraph C12 of IFRS 17 may be applied, to the extent permitted by paragraph C8, for the estimate of future cash flows at the date of initial recognition including insurance acquisition cash flows.

Reporting on other questions submitted (Agenda Paper 7)

29. 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) will be considered through a process other than a TRG discussion (such as part of the annual improvement process).

30. TRG members discussed Agenda Paper 7. No comments were made on most of the topics in the paper. However TRG members made the following observations:

(a) *S03 Presentation of assets and liabilities on the statement of financial position*
The requirements in IFRS 17 are clear. Applying these requirements reflects a significant change from existing practice and this change results in implementation complexities and costs.

(b) *S04 Subsequent treatment of contracts acquired in their settlement period*
The requirements in IFRS 17 are clear. Applying these requirements reflects a significant change from existing practice and this change results in implementation complexities and costs.

(c) *S09 Allocating the contractual service margin at the end of a period to coverage units*
It was noted that paragraphs 76(c) and B119 of IFRS 17 require coverage units to be determined at the end of the reporting period, comparing the service actually provided in the period and the service expected at that date to be provided in the future.

(d) *S20 Grouping contracts using the modified retrospective approach to transition*
The objective of the modified retrospective approach is to achieve the closest outcome to retrospective application possible using reasonable and supportable information available without undue cost or effort. The modification in paragraph C10 of IFRS 17 is only permitted to the extent that the entity does not have reasonable and supportable information for retrospective application. This is different to paragraph C23 of IFRS 17 for the fair value transition approach.

(e) *S23 Premiums received applying the premium allocation approach*
The requirements in IFRS 17 are clear. Applying these requirements reflects a significant change from existing practice and this change results in implementation complexities and costs.

(f) *S26 Variable fee approach when the return is based on amortised cost measurement of the underlying items*
It was noted that the variable fee approach criteria could be met for contracts where the return is based on amortised cost measurement.

31. The Chair of the TRG acknowledged that implementation of IFRS 17 will involve operational burden and therefore costs. He also reminded the TRG members that although the Board is open to receive new and relevant information on implementation, the purpose of the TRG is to provide implementation support as industry experts and not to redeliberate the decisions of the Board because of operational burden and cost.

Next steps

32. The next meeting of the TRG will be held on 2 May 2018. Submissions of implementation questions received after 21 March 2018 are unlikely to be discussed at the meeting on 2 May.