Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Meeting Summary
Hong Kong Insurance Implementation Support Group (HKIISG)
20 March 2018

Attendance
HKICPA representatives
Shelley So, Chair, Financial Reporting Standards Committee (FRSC)
Christina Ng, Director, Standard Setting
Kam Leung, Associate Director, Standard Setting

HKIISG members
Sai-Cheong Foong / Grace Li, AIA Group Limited
Kevin Lee, AXA China Region Insurance Company Limited
Ronnie Ng, China Overseas Insurance Limited
Sally Wang, China Pacific Life Insurance Co., Ltd
Kevin Wong, FWD Life Insurance Company (Bermuda) Limited
Alexander Wong, Hang Seng Insurance
Kenneth Dai, Manulife Asia
Candy Ding, Ping An Insurance (Group)
Nigel Knowles, Prudential Hong Kong Limited
Joyce Lau, Target Insurance Company, Limited
Doru Pantea, EY Hong Kong
Francesco Nagari, Deloitte Hong Kong
Erik Bleekrode, KPMG China
Chris Hancorn, PwC Hong Kong

Guest
Tony Chan, Associate Director, Insurance Authority Policy and Development Division

Discussion objectives:
Readers are reminded that the objective of the HKIISG is not to form a group consensus or decision on how to apply the requirements of HKFRS/IFRS 17 *Insurance Contracts*. The purpose of HKIISG is to share views on questions raised by stakeholders on the implementation of HKFRS 17. Refer to HKIISG terms of reference.

The meeting summaries of HKIISG discussions are solely to provide a forum for stakeholders to follow the discussion of questions raised. Stakeholders may reference HKIISG member views when considering their own implementation questions—but should note that the meeting summaries do not form any interpretation or guidance of HKFRS 17.

1. Introductory remarks
FRSC Chair, HKICPA Staff and HKIISG members introduced themselves. Members provided an overview of their organizations' HKFRS/IFRS 17 implementation progress, including the parallel testings for the Insurance Authority's new Risk Based Capital (RBC) framework.

2. HKIISG sweep operating procedures and tentative meeting dates
Members agreed with a tentative meeting schedule (as published on the Institute's website), including the flexibility to add and cancel meetings when necessary.

Members agreed with the operating procedures:
- meeting papers to be circulated and published around two weeks before each HKIISG meeting;
- late submissions also to be circulated to members; and
- organizations submitting questions will be requested to present their submission at the meetings.

Members noted that all submissions, meeting papers and summaries are made available to the public on the Institute's webpage for educational purposes.

Action
HKICPA Staff to schedule additional meeting dates for 2018 to allow time to discuss potential Hong Kong issues papers for IASB TRG.

Post-meeting Note:
On 26 March, additional meeting dates were scheduled and circulated to HKIISG members. The Institute's webpage contains the latest meeting dates.

3. Update on the status of the new Risk Based Capital framework
Insurance Authority (IA) representative, Mr. Tony Chan, provided an update on the status of the RBC framework (paper 3).

Members asked questions and Mr. Chan responded, in particular:
- the development of Pillar 3 requirements has not begun yet, as the IA needs to finalize the detailed rules and requirements for Pillars 1 and 2 first;
- that the IA and the China Insurance Regulatory Commission (CIRC) entered into the Equivalence Assessment Framework Agreement on Solvency Regulatory Regime whereby a temporary equivalent status was given to Hong Kong for 4 years. A full assessment on mutual equivalence would be carried out afterwards in anticipation of the Hong Kong's RBC framework being developed.

Members emphasized that the IA, in developing the RBC framework, should consider how to rationalize prudential and financial reporting requirements. Given the significant effort and resources that were required for the first quantitative impact study (QIS 1), a request was made to IA to review the results obtained in order to rationalize the requirements for the coming QIS 2 by removing unnecessary work in QIS 1 which had not given relevant insight for the purposes of the QIS. Two members also urged IA to consider whether all existing reported items to IA (e.g. as provided in the quarterly returns) are necessary when HKFRS 17 becomes effective as some of the information currently reported may be driven by the existing standard HKFRS 4.

Members also commented that financial and prudential reporting serve different objectives, and that while there are elements of HKFRS 17 which can be incorporated, or leveraged, in the development of RBC, caution should be exercised in matters such as the determination of discount rates and contract boundaries. The IA should explain and reconcile the differences to assist preparers and users. In response, Mr Tony Chan acknowledged that while the objective for HKFRS 17 is to provide a standard for financial reporting, the objective for the RBC regime is to offer a standard or requirements for solvency assessment by the IA. At the same time, the IA is open in mind for any possible integration between HKFRS 17 and the developing RBC regime, as long as the objective for solvency assessment can be fulfilled.

HKICPA Staff suggested that the discussion on how IA could potentially leverage HKFRS 17 requirements in developing RBC could be discussed at the Institute's Insurance Regulatory Advisory Panel (IRAP). Recommendations would then be provided to IA through IRAP. Mr. Chan welcomed any recommendations for IA's consideration.

Post-meeting Note:
A meeting between IA senior executives and IRAP members has been scheduled to take place in June to discuss recommendations on how to leverage HKFRS 17 requirements for the RBC framework.

4. Debrief of 6 February IASB TRG meeting
IASB TRG members Francesco Nagari, Sai-Cheong Foong and Sally Wang provided a debrief of the 6 February IASB TRG meeting, summarized in paper 4.

Members noted that most of the TRG meeting outcomes provided more clarity and direction on the requirements of HKFRS 17, but cautioned on the operational complexities when implementing:
- the boundary of contracts with annual re-pricing mechanisms; and
- the boundary of reinsurance contracts held.

IASB requested TRG members to provide examples of operational complexity in the following areas:

- presentation of groups of insurance contracts in the statement of financial position;
- premiums received applying the premium allocation approach; and
- subsequent treatment of contracts acquired in their settlement period.

Action

HKIISG members were requested to monitor and share examples of operational concerns if and when they come across these issues in Hong Kong.

5. Consider HKIISG submissions received by 13 March[1]

Paper 5A: Unit of Account

Paper 5A was presented by Ms. Candy Ding of Ping An Insurance. The question was whether the lowest unit of account must be the legal contract after separating non-insurance components. Specifically, the question referred to an example of a legal contract wherein a base life contract has an accidental rider attached to it. The base and rider have different risks and cashflows, and are therefore managed and priced separately. The rider can be added or cancelled at any time: if the rider lapse, the base does not lapse. However, if the base lapse, the rider will automatically lapse as well.

View 1: substance over form prevails

- A few members noted that the IASB TRG outcomes should not be taken as requirements as they are only for reference and not binding. That is, the three considerations discussed at the 6 February IASB TRG meeting are only examples of considerations that a preparer may need to take into account when identifying the lowest unit of account. A comprehensive analysis into each individual fact pattern is important, before concluding on whether the base and rider in question should be treated as a single unit of account, or accounted for separately.
- One member noted that the IASB TRG outcome basically created a rebuttable assumption that the lowest unit of account is the legal contract, which can be rebutted if 'substance over form' prevails.
- Another member considered the base and the rider can be separated even if they are under one contract as they are priced/managed separately and insure different risks.

View 2: high hurdle for overriding the legal form of contract

- One member observed that the IASB's drafting of other standards, such as IFRS 15 *Revenue from Contracts with Customers*, incorporated the separation of distinct performance obligations. This member noted that if the IASB had intended to do the same thing with IFRS 17, then the separation of insurance components within the same legal contract would have been included in the text of the standard. Therefore, this member thinks that entities have a high hurdle to cross before arriving at the conclusion that different insurance components in the same legal contract should be separated.
- The same member noted that even if the entity concludes that different insurance components in the same legal contract should be separated, the follow-on practical questions are enormous—such as how to consider accounting for discounts to packages and the allocation of costs. IFRS 15 outlines the accounting for all these follow-on considerations, but not in IFRS 17. Therefore, this member further emphasized that the IASB's intention in IFRS 17, is that the lowest unit of account is usually the legal contract.
- A few members commented that, based on the IASB TRG outcomes and the standard, they would not separate the rider if it automatically lapse when the base policy lapse.

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1 HKIISG discussion took into account the 6 February IASB TRG meeting paper 1 on the separation of insurance components in a single insurance contract. TRG members had observed that the lowest unit of accounting in IFRS 17 is the contract that includes all insurance components, and that overriding the legal form involves significant judgment and careful consideration. The TRG members had observed three 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 obligations.

Diversity in practice may be pervasive

- Some members commented that the fact pattern in the submission is a very common scenario across many Asian jurisdictions, not only in Hong Kong and China. Therefore, the application of different judgment or interpretation could create diversity in practice which may be pervasive across the region.
- A few members questioned whether HKIISG could arrive at a common approach for a simple fact pattern, in order to provide more guidance for preparers and achieve a more consistent application of the standard. One member also noted that doing so would help entities prepare for implementation in other areas, such as how to allocate the contractual service margin.
- On the other hand, a few members noted that since each scenario would be different, it would be impossible to arrive at a consensus within members. Furthermore, arriving at a consensus based on only one fact-pattern in the submission could result in standardizing the accounting for all transactions with different fact patterns.
- One member commented that although the objective of HKIISG is not to arrive at a group consensus, if HKIISG could provide their views on how they may apply the standard and TRG outcomes on some real life fact patterns, then it may help preparers and auditors in arriving at their conclusions. Other members agreed that having more examples on how to apply the standard and the TRG outcomes would be helpful for preparers, especially considering that even a simple product could already have different risk elements attached to it.
- Members agreed that if the fact pattern in the submission is critical and pervasive in Hong Kong, China and across Asia, then more examples should be obtained, analysed and discussed at HKIISG to develop a more in-depth understanding of the circumstances.

Other critical considerations

- A few members pointed out other critical considerations relating to:
  - allocation of expenses if the rider has a distinct personality; and
  - how the contractual service margin (CSM) and its subsequent allocation would be impacted.

Action/Conclusion:
Refer to action points for paper 5B below.

Paper 5B: Unit of Account and Coverage Units
Paper 5B was presented by Mr. Kevin Lee of AXA China Region Insurance. The questions were:

1. Whether the common features of riders in the Hong Kong market, as outlined in paper 05B, provide sufficient evidence to permit or prohibit the separation of insurance components.
2. How the coverage unit of the contract should be determined, if a contract with different rider coverage is considered as a single contract for measurement purposes.

Rider and base are considered a single unit

- One member commented that there is no basis in IFRS 17 for every rider to be treated as a separate contract. Instead, all available riders (whether active or not) at contract inception, should be considered as part of the contract and portfolio. That is, riders are similar to embedded products. This member further elaborated that:
  - For riders that are not yet active, a 'take up rate' will need to be established to estimate when those riders that will be elected by the customer. Whether riders are sold at market price or have a guaranteed price at the point of sale also needs to be considered.
  - When a new rider is developed and becomes available for customer subsequent to contract inception, then it should be treated as a new contract.
  - If a rider is canceled, then it should be treated as a modification and cashflows are modified accordingly.
  - Coverage units are calculated subject to the take up rate, and riders which are not yet activated cannot earn any coverage units.

- Once a rider is activated, then the take up rate changes and the cashflows are modified, which impacts the CSM and its subsequent amortization.

Another member commented that this seemed conceptually similar to an extension or conversion option within a contract.

- On the other hand, another member commented that accounting for all riders that exist at contract inception may be disastrous as quite often riders may not exist in one or two years and customers may never end up taking up the rider. Hence, assumptions for take up rates should not be made for riders.

<u>Substance over form prevails</u>

- A few members reiterated that the IASB TRG outcomes are for consideration and should not drive people to account for the contract as a single unit when the substance of the rider and base are considered to be different.

<u>Other critical considerations</u>

- One member commented that if the position is taken that the rider and base cannot be separated, and a single contract considers the take up rate of all available riders at inception, than how should an entity:
  - measure coverage units on that contract; and
  - achieve a reasonable pattern of amortization (For example: should rider CSM be amortised over the same duration as basic policy CSM, or should the rider premium match its corresponding risk covered?)
- Members agreed that if riders and base cannot be separated, this may present an enormous operational complexity for insurers across Asia, as this business practice is extremely common and riders are frequently sold as add-ons to the basic policy contract.
- A few members noted that the consequences of viewing the rider and base as a single contract may mean that the business practices of insurers may change to 'simplify' accounting, i.e. separate contracts will be issued for each rider and base.
- A few members commented that if HKIISG wants to argue that riders and base policies (such as those common in Hong Kong and China) should be accounted for separately, it should be done through a submission to the IASB TRG which contains broader considerations on: initial recognition; subsequent measurement; modification; coverage units; risk adjustments; expenses; and other assumptions. Furthermore, HKIISG should be able to articulate the issue with more real life examples.
- Since the 2 May IASB TRG meeting will focus on coverage units, members agreed to provide and analyse additional examples in conjunction with the May TRG outcomes on coverage units.

<u>Action/Conclusion:</u>
Members were requested to share more fact patterns so that HKIISG can further discuss how the standard and TRG outcomes should be applied, and assess the diversity of the conclusions.

Paper 5C: Discount Rate
Paper 5C was presented by Ms. Candy Ding of Ping An Insurance. The submission outlined the following observations arising from reading the standard:

- a current discount rate is applied for initial recognition and subsequent measurement of fulfillment cashflows (FCF)
- there is an option to disaggregate insurance finance income and expenses between profit and loss and OCI for changes in assumptions that relate to financial risk that do not have a substantial effect on the amounts paid to policyholders, using the current discount rate determined on initial recognition
- if the OCI option is elected, there is also a choice to use a weighted average discount rate (instead of the current discount rate determined on initial recognition)
- however, if a weighted average discount rate is elected for the OCI option, there will be a difference between measuring FCF at a current discount rate, and measuring insurance finance income and expense at a weighted average discount rate

Based on these observations, the question asked what the discount rate should be used for the initial recognition of a group of contracts (current or weighted-average).

View 1

- A few members noted that the current discount rate on initial recognition of a group of contracts cannot be revisited, and that any difference between current discount rate used on initial recognition and the weighted average discount rate used in subsequent measurement would be reflected in the income statement. This is based on the reading of paragraphs B131 and B132.

View 2

- One member noted that the group of contracts would effectively be recalculated at each reporting period using the weighted average discount rate, based on paragraph B73. However, paragraph B137 must adhered to, which means that accounting estimates of previous interim periods cannot be recalculated. Therefore, recalculating the group of contracts using the weighted average discount rate in the current interim period would effectively 'true-up' the overall estimate.
- Another member commented that in another jurisdiction, entities will likely recalculate the weighted average discount rate for each reporting period (at 3 months, then 6 months, then 9 months etc). This means that any 'difference' is adjusted in the current quarter and the group of contracts is recalculated at each reporting period.
- Two other members noted that some entities are considering maintaining cohorts which match their interim reporting schedule, which would mean a huge volume of data to keep track of.

Other considerations

- One member noted that smaller general insurers will have limited resources to develop discount rates. Therefore, they would look for a general prescribed rate.
- IA noted that for purposes of testing for the new RBC framework, they had provided entities with a yield curve.
- Another member noted that if the IA's yield curve can be tested and entities are satisfied that it represents current market data, then it could be a free source for entities to refer to. This would be similar to European practices, where regulators regularly publish term structures.

Action/Conclusion:

HKICPA Staff will bring back on analysis of the question for discussion at a future HKIISG meeting.

6. Any other business

Paper 5D (late submission) will be discussed at the next HKIISG meeting.

One member commented that it is important to ensure that all stakeholders, including users and the Internal Revenue Department, are aware of HKFRS 17. The same member commented that an educational plan for smaller general insurers in Cantonese would be useful.

IA representative asked how will HKIISG resolve the judgment areas and suggested that communication of some common approaches may be helpful to achieve consistency across all businesses.

HKICPA Staff commented that HKIISG meeting summaries will available to the public for reference. HKFRS/IFRS 17 is principle-based so that companies can account for a broad range of fact patterns that faithfully represent the substance/economics of the transaction, so judgement is inevitable. If there are areas with pervasive diversity in practice, then it would be brought to the FRSC's attention, and to the extent needed, to the IASB. If the issue is Hong Kong specific, FRSC may consider local guidance, if necessary.

HKICPA Staff also outlined the FRSC's plan to hold a forum between insurance stakeholders at the end of the year to discuss relevant key matters that arise from IASB TRG and HKIISG meetings.