



Meeting Summary
Hong Kong Insurance Implementation Support Group (HKIISG)
27 April 2018

Attendance

HKICPA representatives

Sanel Tomlinson, Member, Financial Reporting Standards Committee (FRSC)
Christina Ng, Director, Standard Setting
Kam Leung, Associate Director, Standard Setting

HKIISG members

Grace Li (representing Sai-Cheong Foong), AIA Group Limited
Kevin Lee, AXA China Region Insurance Company Limited
Ronnie Ng, China Overseas Insurance Limited
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

Apologies

Sally Wang, China Pacific Life Insurance Co., Ltd

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. Opening remarks

Members were reminded to provide their comments on the 20 March HKIISG meeting summary by 3 May. The meeting summary will be subsequently published on the HKICPA webpage and promoted to stakeholders through the Institute's communication channels.

Post-meeting Note:

On 7 May, the 20 March HKIISG meeting summary was published on the Institute's [webpage](#).

2. Consider 2 May IASB TRG meeting papers

AP06 – Implementation challenges outreach report

Readers should refer to [IASB TRG Paper AP06](#) before reading this meeting summary.

IASB TRG member Mr. Francesco Nagari introduced AP06 (refer to pages 6 and 7 of [Briefing on IASB TRG Papers for 2 May meeting](#)).

Objective of AP06 is unclear

Members commented that the IASB staff's objective with AP06 is unclear. That is, what

does the paper want to achieve and what are the potential next steps? Members commented that this should be raised at the IASB TRG meeting.

Members also commented that although the three topics outlined in AP06 are operationally complex, they are not the most significant implementation challenges for Hong Kong insurers. Members emphasized that there is a much broader range of implementation challenges which are not addressed by AP06.

Presentation of groups of insurance contracts in the statement of financial position

Members generally commented that they did not understand the usefulness of the requirement to present separately in the statement of financial position the carrying amount of groups of insurance contracts issued that are assets and those that are liabilities. Members argued that investors and senior management assess groups of contracts on a net asset/liability basis. Hence, there is little information value at the gross asset or liability level of the group of contracts.

A few members noted that, operationally, all insurers would have the data necessary to meet this requirement. However, they noted that educating investors and senior management on how to understand the statement of financial position in IFRS 17 is the main challenge.

Finally, a few members noted that although they could understand the rationale for separately presenting assets and liabilities (to align with the *Conceptual Framework* and HKAS 1 *Presentation of Financial Statements*), it was more challenging to appreciate the IASB rationale from a cost-benefit perspective—in particular, since it is not clear that investors of insurance companies actually find it useful to have information presented this way.

Premiums received applying the premium allocation approach (PAA)

The PAA model focuses on premiums received. However, one member commented that legally, the consideration of an enforceable contract consists of both the premium receivable and received. Another member noted that the interpretation as presented in the paper will impact their current system of internal controls and reporting processes.

Subsequent treatment of insurance contracts acquired in their settlement period

IFRS 17 requires different accounting treatments for entities that issue insurance contracts versus entities that acquired insurance contracts. In particular, the requirements enable a buyer which acquired an insurance contract in its settlement period to recognize revenue. However, for the same contract, the seller is not allowed to recognize revenue during the settlement period. One member commented that this difference in accounting may be difficult to explain to investors.

Action:

IASB TRG members will communicate the key points above at the TRG discussion on May 2.

AP07 – Reporting on other questions submitted

Readers should refer to [IASB TRG Paper AP07](#) before reading this meeting summary.

IASB TRG member Mr. Francesco Nagari introduced AP07 (refer to page 8 of [Briefing on IASB TRG Papers for 2 May meeting](#)).

Modifications to retrospective approach

Some members commented that there seemed to be a lack of guidance for when it is deemed impractical to apply a fully retrospective approach, and when there is reasonable and supportable information to apply a modified retrospective approach. Another member noted that since only permitted modifications are allowed for the modified

retrospective approach, many insurers may end up applying the fair value approach, which is not desirable. The following factors to consider were raised:

- Existence of sufficient data for allocation of profit and expenses
- Impact of changes in IT systems over the years
- Impact of changes in company ownership over the years
- There are jurisdictions that applied accounting policies or complied with a local pronouncement grandfathered under IFRS 4 which were based on an earlier exposure draft of what has now become IFRS 17. A question was raised as to whether or not the residual margin accounted for under such policies be sufficient to meet the full retrospective approach or modified retrospective approach, and be used as the restated CSM

One member emphasized that the transition approach is particularly relevant to the insurance industry as insurance contracts could arguably last more than 20 years. This member noted that the actual question is, how insurers can prove that data (which is over 20 years old) is accurate and complete. That is, what tools may be available to reconcile this time and data gap.

One member noted that this complex matter is so specific to individual companies that it should be a conversation between insurers and their auditors. Another member shared that operationally, they would apply the 'old' or 'different' data to the requirements of IFRS 17, and then analyse (with their auditors) if it is sufficient for the application of the full retrospective, modified retrospective or fair value approach.

Members commented that this topic should be raised at the IASB TRG meeting, and that potentially, a Hong Kong submission for a future IASB TRG meeting could be formed.

Finally, one member observed that many of the IASB's responses in AP07 included the sentence "any consideration beyond this is actuarial in nature and therefore does not fall within the remit of the TRG", which was not deemed particularly helpful.

Action:

IASB TRG members will communicate the key points above at the TRG discussion on May 2.

AP03 – Cash flows within the contract boundary

Readers should refer to [IASB TRG Paper AP03](#) before reading this meeting summary.

IASB TRG member Mr. Francesco Nagari introduced AP03 (refer to pages 3 and 4 of [Briefing on IASB TRG Papers for 2 May meeting](#)).

Practical ability to reprice at the renewal date

AP03 notes that the term "practical ability" does not specify the sources of contracts, and therefore, market competitiveness and commercial considerations are factors that can be taken into account. However, AP03 also notes that a constraint is not equal to making pricing decisions and pricing would be subject to further judgment as to whether practical ability is affected or not.

A few members consider that market competitiveness always exists, because insurers do not price in a commercial vacuum. Therefore it seems that one could argue that there would always be a constraint on the entity's practical ability to reprice.

A few members noted market competitiveness as a constraint only applies when there is a difference in repricing for existing policyholders versus setting a price for new policyholders. These members thought that AP03 was non-controversial if this consideration remains the foundation of the contract boundary requirement.

One member provided an example of jurisdictions where there is pseudo-regulatory pressure on insurers not to reprice for existing policyholders. HKICPA staff was requested to reach out to the related national standard setter for more details. On a separate note, this member noted that it is difficult to prove/demonstrate to your auditor that the competition is so fierce that it impedes your practical ability to reprice.

One member gave an example of a 5 year construction contract whereby the premiums dropped by one third from 2003 to 2007. These contracts are typically extended, however insurers find that competition is so fierce that they cannot reprice the contract extensions as there will be insurers willing to take up the contract extension at the current 'low' price.

Options to add insurance coverage where the terms are guaranteed

Members did not comment on this topic. One member noted that it was technically clear what the requirements in IFRS 17 are, but that in practice, there needs to be judgment involved.

Options to add insurance coverage where the terms are not guaranteed

Members noted some similarity with submissions discussed at the [20 March HKIISG meeting](#) relating to base policies and additional riders.

One member noted that paragraph 40 of AP03 seems to create a link between the practical ability to reprice a contract and the occurrence of when an option is taken up.

A few members noted that, from a practical perspective, even if an insurer concludes that options are within the contract boundary, it may not be reasonable to include it in the cash flows as it has not been taken up by the policyholder yet. One member noted that if options are within the contract boundary, it may create scenarios where insurers could add a rider with a high benefit coverage but low probability of occurring (i.e. airplane risk with huge coverage), and assuming the policyholder takes it up, may accelerate the profit recognition because CSM would include this quantity of benefits in its calculation of coverage units.

Members also debated on when exactly to start amortising the CSM of non-guaranteed riders into the P&L: when it is sold as part of the base policy, or when it is activated by the customer.

Members commented that these issues needed to be raised at the IASB TRG, along with a holistic consideration of the combination of insurance contracts, separation of insurance components in a contract, and determining the quantity of benefits for coverage units.

Action:

IASB TRG members will communicate the key points above at the TRG discussion on May 2.

AP04 – Boundary of reinsurance contracts held with repricing mechanisms

Readers should refer to [IASB TRG Paper AP04](#) before reading this meeting summary.

IASB TRG member Mr. Francesco Nagari introduced AP04 (refer to page 5 of [Briefing on IASB TRG Papers for 2 May meeting](#)).

A few members noted that AP04 refers to the ability of some reinsurers to terminate coverage at any time with a three month notice period, and that in these cases, the contract boundary would exclude cash flows arising outside the three month notice period. However, AP04 also says that the right to terminate coverage which 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 for the cedant. Members noted

that AP04 seems to open up the contract boundary for the cedant, regardless of the reinsurer's ability to reprice.

Another member questioned how the contract boundaries for a reinsurance contract from the cedant and reinsurer perspectives, would differ.

One member commented that it was important to understand if AP04 refers to proportional (reinsurer follow terms of underwriting policy and shares a proportion) or non-proportional (i.e. excess of loss where the reinsurer covers all losses for a specified period) reinsurance treaties. This member noted that if it was an excess of loss contract, then it may not be meaningful to discuss the differing contract boundaries as the reinsurer covers all loss of that underlying policy for a specified period of time.

Another member responded that the staff paper covered both types of treaties. For example, if a cedant purchases a 12 month excess of loss reinsurance treaty and the reinsurer has the right to reprice at end of each quarter, then, all the outflows and recoveries need to be included into the estimation of cash flows for the cedant even though the reinsurer has the ability to reprice at each quarter end.

One member commented that the nuance in deliberating the contract boundary should be the right to cancel, not the right to reprice. Another member commented that there are two elements to consider: the inforce policy in the reinsurance treaty of which the cedant has no right to cancel (and therefore is included in the contract boundary); and the element of future cession whereby from the cedant perspective, there is the right to pull the product immediately. From that perspective, although the cedant has no right to cancel, it can still pull the product immediately, meaning that it is effectively cancelled. Another member commented that the practical ability to cancel the policy should be considered, i.e. even though the right exists the chance that the right is exercised is minimal, and hence the cancellation right would still be in the contract boundary.

Members noted that future TRG meetings should discuss reinsurance in more detail, and proposed that HKIISG considers making a submission to the IASB TRG.

IASB TRG Paper AP05 – Determining the quantity of benefits for identifying coverage units

Readers should refer to [IASB TRG Paper AP05](#) before reading this meeting summary.

IASB TRG member Mr. Francesco Nagari introduced AP03 (refer to page 5 of [Briefing on IASB TRG Papers for 2 May meeting](#)). HKICPA staff then recapped the discussion on 20 April relating to AP05. This section of the meeting summary includes members comments made at the 20 April HKIISG meeting.

Supportive of IASB staff proposal for narrow amendment

One member noted that the IASB staff proposal to change the text of the standard creates simplicity—given the distinction in the measurement models of direct and indirect participating contracts in IFRS 17—and is therefore attractive and workable. This member notes that trying to broaden the staff proposal to cover both direct and indirect participating contracts would be challenging given the distinction of the measurement models. This member thinks that AP05 is a logical consequence following on from the different models.

Another member commented that the proposed narrow amendment is sufficient, and that any broadening of the amendment would not be solving the fundamental debate on different measurement models for direct and indirect participating contracts. This member further noted that many things affect the earnings pattern, and that this narrow amendment is only one factor. This member emphasized that the bigger problem is the debate on the definition of coverage units.

Another member questioned what the alternative proposal is if members do not agree with the IASB staff proposal.

IASB staff proposal needs to be broadened

Members expressed concerns that the IASB staff paper creates different accounting for two economically similar contracts. Members noted that it is not necessary to have the bright line distinction between coverage units for Variable Fee Approach (direct participating contracts) and non-VFA contracts (indirect participating contracts). One member questioned if HKIISG should submit a paper to the IASB TRG in relation to commonly seen insurance products with investment components in the region, and an analysis of:

- whether the related contracts are in the scope of the variable fee approach (VFA);
- how IFRS 17 principles would be applied to these contracts, in particular, in identifying the coverage units and the recognition of CSM;
- what resulting differences arise between contracts under VFA approach versus the general measurement model, and whether it makes conceptual sense.

One recommendation was that all contracts should have to take into account the service that relates to asset dependency for its coverage units. This is because in principle, CSM relates to service provided, and should not be split between investment or insurance service.

Another member commented that the staff paper creates a bright line in accounting for two economically similar contracts. Should the IASB staff proposal be broadened, it could be done in the following ways:

- Follow same logic as measurement models for simplicity; or
- CSM for all services amortised for duration of all elements in contracts; or
- For indirect participating contracts which are predominantly insurance, recognize CSM for insurance only, and the rest of the contract is an "earn as you go" basis.

One member commented that insurers should test the assumption that having the same model for direct and indirect participating contracts is reasonable. For example, how the recognition of profits for commonly seen contracts will differ by applying the variable fee approach and general measurement models. One member reminded members to consider the impact of having a CSM at a locked-in discount rate for indirect participating contracts.

Another member noted that the discussion on insurance or investment coverage units should be broadened and expanded to multiple coverage units. This member advocated a steady recognition of profits throughout the contract. However, the member stressed that a wider consideration needs to be given to the type of services being provided, and a reasonable way to allocate them to coverage units.

A few members commented on examples 14 and 13 in the IASB TRG paper, which would accelerate and defer profit recognition, respectively if the investment-related services were not included in the calculation of the coverage units. These members did not think the outcomes were reasonable. Members noted that it may lead to product accounting arbitrage or structuring so that profits can be recognized earlier or later depending on the insurer's preference. In particular, one member commented that in the Hong Kong China region, most insurance products have an investment component. If these products do not meet the VFA criteria, then accounting for it would mean a higher contractual service margin (CSM) is allocated to the earlier years and a number of later years will have little or no CSM allocation to P&L.

One member commented that example 15 in the IASB TRG paper seemed to be representative of common Hong Kong products. This member argued that 'surrender



value' is still a service regardless of whether the contract is indirect or direct participating contract. Therefore, it should be included in coverage units.

Another member commented that the difference in profit recognition for economically similar contracts would impact the dividend distribution of a company, and is therefore difficult to explain to investors and senior management.

Overall

Members supported an amendment to IFRS 17 regarding this topic. However, there were mixed views as to supporting a narrow amendment as per the IASB staff proposal in AP05, or supporting a broader amendment which allows coverage units between insurance and investment services to be treated similarly in all contracts with asset-dependent cash flows.

Action:

IASB TRG members will communicate the key points above at the TRG discussion on May 2.

IASB TRG Paper AP01 – Combination of Insurance Contracts

Readers should refer to [IASB TRG Paper AP01](#) before reading this meeting summary.

IASB TRG member Mr. Francesco Nagari introduced AP01 (refer to page 9 of [Briefing on IASB TRG Papers for 2 May meeting](#)). HKICPA staff recapped the discussion on 20 April relating to AP01. This section of the meeting summary includes members comments made at the 20 April HKIISG meeting.

Judgment required and consistent principles

One member noted that IFRS 17 paragraph 9 helps to address situations where some companies sell two contracts with risks which offset each other. However, in this submission to the IASB TRG, it seems the submitter may want to question whether the combination of contracts can be applied to a broader range of commercial considerations. This member noted that the application of IFRS 17 paragraph 9 should be a judgment call and that principles, similar to those for the separation of insurance components in an insurance contract (discussed at the February IASB TRG meeting), should be applied.

One member noted concerns on the possible misinterpretation of paragraph 16 in AP01, which may lead readers to strictly adhere to 'form over substance'. However, IFRS principles should be substance over form. This member noted that the key view in AP01 should be in paragraph 18 which states that "determining whether to combine contracts involves significant judgment and careful consideration of all relevant facts and circumstances". Another member further noted that paragraph 19 is also a key view for insurers to take into consideration.

One member commented that general insurers may sell loss making contracts together with profit making contracts, for example, loss making motor insurance contracts and profit making property insurance contracts. If these contracts cannot be combined under IFRS 17, then insurers may end up structuring their contracts to include both motor and property insurance in the same legal contract—which may not be the intent of the IASB staff in writing paragraph 16 of AP01.

One member also questioned the reasonableness of paragraph 21 in AP01 which states that "the existence of a discount, in itself, does not mean that a set or series of contracts achieve an overall commercial effect". For example, an insurer may offer rider to a policyholder at an extremely high discount, (i.e. for commercial reasons)—and questioned if the rider and the base policy should be combined or separately accounted for.

Overall, members commented that the principles should be consistent when considering questions relating to the separation of insurance components in an insurance contract, the combination of contracts, as well as the boundary of a contract.

Combination of contracts issued several years apart

One member raised the question of how timing relates to the combination of contracts, i.e. if a rider is issued 10 years after the base policy to prevent a policyholder from lapsing their base policy. This member noted that these riders may not meet the modification requirements of IFRS 17 paragraph 72, and questioned whether IFRS 17 paragraph 9 can be applied in these circumstances.

Other comments

HKICPA staff commented that IASB TRG members should communicate to the IASB that more education may be required, on a holistic level, on how to apply the standard consistently when considering the separation of insurance components in an insurance contract, the combination of contracts, as well as the boundary of a contract. It was noted that the combination of contracts is not an accounting policy choice.

Action:

IASB TRG members will communicate the key points above at the TRG discussion on May 2.

IASB TRG Paper AP02 – Risk adjustment in a group of entities

Readers should refer to [IASB TRG Paper AP02](#) before reading this meeting summary.

IASB TRG member Mr. Francesco Nagari introduced AP02 (refer to page 10 of [Briefing on IASB TRG Papers for 2 May meeting](#)). HKICPA staff recapped the discussion on 20 April relating to AP02. This section of the meeting summary includes members comments made at the 20 April HKIISG meeting.

Some members were supportive of the general direction of AP02

One member noted that multinational companies will often have subsidiaries operating in different jurisdictions with different solvency and legal requirements. These subsidiaries conduct the pricing of their products at the entity level. This member therefore noted that it makes sense to calculate the risk adjustment from the perspective of the subsidiary. Another member further noted that non-financial risk is typically managed at the subsidiary level and therefore should be calculated from that perspective.

One member noted that AP02 seemed reasonable but that the paragraphs 16 to 19 did not explain the rationale of the IASB staff thinking clearly enough.

A few members expressed concerns on AP02

One member noted that since diversification benefits is non-linear (i.e. the bigger the portfolio the bigger the benefit), the diversification benefit would be different at the consolidated level versus the subsidiary standalone level. To illustrate this point, another member commented that if a group company has subsidiaries which each sells different products, then the group company would have a diversification benefit which may not be available at the subsidiary level. A member further noted that one jurisdiction currently allows two different risk adjustments for entity and consolidated financial statements of general insurers.

A few members noted that IFRS 17 does not prescribe a single risk adjustment at both the entity and consolidated level. However, paragraph 21 of AP02 states 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 entity. It raises the question whether the standard will require amendment if it is concluded that only one view is allowed.



Other comments

One member noted that insurers should consider the impact of materiality when calculating the non-financial risk adjustment, because introducing diversification benefits into the calculation would make it more volatile and unpredictable. This member also cautioned against confusing the non-financial risk adjustment in IFRS 17 with the risk margin in the new Risk Based Capital regime being developed in Hong Kong by the Insurance Authority.

Members noted that education is required on the topic, in particular, subsequent to the TRG meeting outcome.

Action:

IASB TRG members will communicate the key points above at the TRG discussion on May 2.

3. Any other business

HKICPA staff confirmed that the next HKIISG meeting is on May 10.

HKICPA staff explained that the purpose of the upcoming HKIISG meeting on June 27 is to discuss submission received (if any), and also to formulate potential Hong Kong submissions for a future TRG meeting.