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

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

Attendance
HKICPA representatives
Gary Stevenson, Member, Financial Reporting Standards Committee (FRSC)
Christina Ng, Director, Standard Setting
Kam Leung, Associate Director, Standard Setting

HKIISG members
Dennis Chiu (representing Sai-Cheong Foong), 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)
Carrie Yip (representing Nigel Knowles), Prudential Hong Kong Limited
Sunny Hassan (representing Joyce Lau), Target Insurance Company, Limited
Frank Wong (representing Doru Pantea), EY Hong Kong
Francesco Nagari, Deloitte Hong Kong
Paul Melody (representing Erik Bleekrode), KPMG China
Chris Hancorn, PwC Hong Kong

Guest
Dr. Roman Sauer, Allianz

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 took note of the June IASB Board meeting, where the IASB decided to propose minor amendments to IFRS 17 *Insurance Contracts* as part of the IASB's *Annual Improvements to IFRS Standards Cycle*.

In particular, the IASB tentatively decided to propose to clarify the definition of the coverage period for insurance contracts with direct participation features[1]. The proposed amendment would clarify that the coverage period for such contracts includes periods in which the entity provides investment-related services.

2. Consider draft submission to TRG – coverage units

Mr. Francesco Nagari and Mr. Alexander Wong presented Paper 02a which is a draft submission to the IASB on coverage units.

The paper presents the two example fact patterns based on products sold in the Chinese

1 More details on the proposed annual improvement on coverage units can be found here: https://www.ifrs.org/-/media/feature/meetings/2018/june/iasb/ap02b-ic.pdf

market including Hong Kong: a universal life contract and a deferred annuity contract. It then analyses the contracts against the requirements in the standard assuming two scenarios: one where the contract does not qualify for the variable fee approach; and one where the contract qualifies for VFA. The paper also includes illustrations of the potential impact to financial statements in terms of CSM recognized on the balance sheet and released in the profit or loss, over time. Three views are expressed, based on IFRS 17 requirements and recent IASB TRG discussions, on what the quantity of benefits and coverage period could be for each contract in each scenario.

One member explained that the paper focuses on contracts which have cash flows that vary[2] based on the returns from underlying items, which is usually caused by the investment component of the contract. This member emphasized that the variability in cash flows for these contracts is similar whether or not they meet the criteria for VFA (paragraph 45) or modified general model (paragraph 71).

Example 1 Scenario 1: Universal Life contract that does not qualify for VFA
Most members commented that view A (coverage period ends when the account value exceeds the sum assured) would appear to be the more technically accurate reading of IFRS 17 requirements as based on previous IASB TRG discussions.

Nevertheless, the same members commented that view B (coverage period is the entire contract period) appears to be a possible alternative way to interpret IFRS 17 requirements which would more faithfully represent the economic substance of the contracts. In support of this view, they commented that the release of CSM when comparing view A and view B (as illustrated in the paper), would potentially result in two different presentations for two economically similar contracts. They commented that this would be awkward for businesses to explain (many insurers in Asia issue indirect participating contracts). A few members also suggested that perhaps other alternative investment examples could be considered for inclusion in the paper. In addition, one member further explained that the reason view B reflects the insurance contract as having the insurance service period extend beyond the point where the account value exceeds the sum assured, is because insurers are standing ready from the day they issue the contract to pay the sum insured in the future, regardless of when the account value exceeds the sum assured.

A few members noted that the IASB is already aware of this point, and questioned if the paper illustrated a strong and/or holistic enough argument for view B to warrant discussion or debate at the forthcoming IASB TRG. Furthermore, these members noted that including investment services as part of the coverage period for the general model (i.e. view B) would be a fundamental change to IFRS 17 in the eyes of the IASB.

One member cautioned against the unintended consequences of view B. For example, in the later years of the coverage period there would be a large portion of CSM on the balance sheet which would be insensitive to changes in underlying items or interest rates. This is because the CSM for contracts which do not meet the VFA criteria cannot be adjusted for the entity's share of changes in the fair value of underlying items, and the discount rate for these contracts cannot reflect the variability of the underlying items. This member commented that this may result in volatility in shareholder equity.

A few other members noted that it is not immediately clear whether the contract would fall into view A or view B, as it would largely depend on the details in the design of the contract.

2 Whether because of contractual terms or the entity's discretion, and regardless of whether the entity holds the underlying items

Example 1 Scenario 2: Universal Life contract qualifies for VFA
Most members commented that if the contract fell within the scope of the VFA, then either view B or view C (coverage period is the entire contract period) would be appropriate.

Example 2: Deferred annuity product
Members had no further comments.

Other comments
Staff noted that they could also discuss the paper with national standard setters from other jurisdictions to obtain their views. One member noted that the scale of indirect participating contracts not qualifying for the VFA approach is much more limited in Europe, as compared to Asia.

Members were also reminded that the draft submission cannot be submitted to the IASB TRG by the HKICPA; unless it is discussed and approved by the HKICPA's Financial Reporting Standards Committee.

Action/Conclusion:
- Staff will discuss the paper with national standard setters from other jurisdictions to obtain their views.
- The draft submission will be submitted to the IASB TRG in the name of one or more of the company representatives from AXA, Deloitte and/or HSBC/Hang Seng who were involved in the drafting of the submission.

3. Consider updated HKIISG submission on loss component
Mr. Kevin Wong presented updated Paper 03a. The submission observed that IFRS 17 distinguishes contracts expected to be profitable or loss-making at initial measurement date, in that:
- CSM will be established for a profitable contract as a measure of unearned profit; and
- a loss component is established when a loss is expected.

The example in the submission is based on a contract which is onerous at inception, and subsequently becomes profitable, resulting in a CSM being established after the loss component becomes zero.

In particular, the submission focuses on how experience adjustments arising from premiums received that relate to future service would affect the loss component.
The view expressed in the submission is that the type of adjustments which impact the CSM (and hence impact the recognition of insurance revenue) is the same for the loss component.

Loss component—adjustments are asymmetrical to those for CSM
One member expressed the view that the loss component liability represents expected cash outflows which are in excess of cash inflows (and therefore, by definition, the loss component constitutes a liability for future cash outflows only). The loss component also cannot result in insurance revenues as any changes in the loss component is always recognized in the insurance service expenses line item.

An addendum to paper 3 will be prepared by this member, in particular to discuss how experience adjustments arising from premiums received that relate to future service would work in the context of the loss component liability for onerous contracts. This additional paper will be presented as an addendum to the paper 3 at the next HKIISG meeting.

Loss component—adjustments are symmetrical to those for CSM
A few members commented that the adjustments impacting the CSM, also impact the loss component. In particular, the loss component takes into account both cash inflows and outflows because paragraph 50 does not specify that it only contains cash outflows.

Action/Conclusion:
Mr. Francesco Nagari would provide an addendum to this paper to be discussed at the 26 July meeting, which expresses the view that the adjustments impacting the loss component will differ from those for the CSM.

[Post-meeting note:
One member noted that Example 8 of the Illustrative Examples on IFRS 17 Insurance Contracts, illustrates how, for an onerous group of insurance contracts, an entity reverses losses from the loss component of the liability for remaining coverage when the group becomes profitable, and then establishes a CSM.]

4. Update from staff on implementation challenges/issues
HKICPA staff presented Paper 04. Members asked questions, and in particular, it was noted that:

- The Hong Kong Federation of Insurers is conducting activities to understand the implementation challenges of both general and life insurers in Hong Kong. Staff will monitor the results of such activities.
- It appears the Malaysian TRG may be established towards the end of the life cycle of the IASB's TRG which may potentially increase the risk of IFRS 17 localization in that jurisdiction. Staff noted that they would monitor the situation.
- Staff will provide feedback on implementation challenges to the IASB after assessing:
  - what the challenges are;
  - if there are new challenges that the IASB have not been informed of; and
  - after considering when and what is the appropriate time/form of communication.
- Staff have reached out to IASB staff to understand why previous IASB TRG submissions on the transition approach were deemed to be answerable using only the words in IFRS 17 and hence not discussed at the TRG meetings. Staff will update members at a future HKIISG meeting.

Action/Conclusion:
Staff will update members on the discussion with IASB staff at a future HKIISG meeting.

5. Any other business
Members agreed to cancel the 4 July HKIISG meeting. For the four half-day meetings scheduled in September, HKICPA staff proposed to survey members on whether they should be combined into two full-day meetings instead.

[Post-meeting note:

- *Members indicated their preference to combine the 11 & 12 September, and 17 & 18 September half day meetings into two full day meetings on 12 and 18 September, respectively. The meeting schedule on HKICPA's webpage has been updated accordingly.]*

6. IFRS 17 sharing
Dr. Roman Sauer, Group Chief Accountant of Allianz, shared:

- an overview of the endorsement process in Europe;
- key takeaways from Allianz's participation in the EFRAG case study; and
- an overview of IFRS 17 implementation issues identified to date and proposed solutions.

Members then participated in a questions and answer session with Dr. Roman Sauer.