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

Meeting Summary
Hong Kong Insurance Implementation Support Group (HKIISG)
18 September 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
Dennis Chiu (representing Sai-Cheong Foong), AIA Group Limited
Kevin Lee, AXA China Region Insurance Company Limited
Ronnie Ng, China Overseas Insurance Limited
Yibing Kong (representing Sally Wang), China Pacific Life Insurance Co., Ltd
Kevin Wong, FWD Life Insurance Company (Bermuda) Limited
Alexander Wong, Hang Seng Insurance
Steven To (representing Kenneth Dai), Manulife Asia
Carrie Yip (representing 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
Candy Ding, Ping An Insurance (Group)

Guest
Alain Beland, Swiss Reinsurance

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

The upcoming meetings on 9 and 10 October have been combined into one meeting on 9 October. Therefore, the meeting on 10 October is cancelled.

In relation to the local submission[1] on the discount rate to be used on initial recognition, staff updated members that the operational complexities[2] of using the a current discount rate on initial recognition of fulfillment cash flows had been communicated to IASB staff. That is, IFRS 17 paragraph B73 is not intended to be applied to the initial recognition of fulfillment cash flows. IASB staff are sympathetic to the operational complexities but note that the requirement is conceptually sound. They also noted that no other jurisdiction or company have raised this specific question/concern.

1 20 March meeting paper 5C, 10 May meeting paper 4, 26 July meeting summary item 3.
2 Refer item 4 in the 26 July meeting summary.

Staff reminded members that if companies consider that an average discount rate of some sort must be applied for practical purposes, they should consider materiality and document the impact of any potential differences between using a current rate per IFRS 17 requirements versus an average rate in practice.

2. Discussion of IASB September TRG meeting papers

Readers must read the IASB September TRG summary briefing and the respective TRG papers for the background and description of the issues and arguments discussed.

AP01: Insurance risk consequent to an incurred claim

One member questioned the difference between view A and view B. Another member responded that:

- View A (consequential insurance coverage being part of the liability for remaining coverage)
  - Requires two different coverage units; the first would unlock CSM based on the original coverage, and the second is to determine coverage units going forward upon the disability occurring. There could be three or more different coverage periods.
- View B (consequential insurance coverage being part of the liability for incurred claims)
  - Does not require different coverage units. Upon the disability occurring, the disabled persons' CSM would stop unlocking with the corresponding coverage units suspended and a liability for incurred claims recognised. Any experience adjustments on the LIC would be recognized in the P&L.

Members generally supported View B, as it is operationally simpler to apply in practice, and is more consistent with the non-life business and PAA model. However, a few members noted that leaving open, the option of applying View A or View B depending on the type of product, facts and circumstances is appropriate. This is because the fact pattern can vary greatly, for example, a person with a disability may never recover, whereby damage to a property can arguably be fully reinstated.

A few members raised the following concerns:

- The argument supporting both View A and View B creates a link between the risk of variability in the amount of claims with the definition of insurance risk—this creates potential massive unintended consequences for the non-life business.
- The conclusion of the paper—which states that it is a matter of judgment for entities and that the IASB would consider to take any action if evidence emerges that diversity is widespread and has a material effect—arguably can be applied to other areas of IFRS 17.
- The submission does not analyse other more complicated fact patterns such as:
  - Multiple critical illness products (which are often bundled with a death benefit and investment component).
  - Multiple claims (i.e. recovery then further disability; or a natural disaster occurs and then another occurs during the claims period).
  - In these cases, even view B is operationally difficult to apply in practice. Therefore, it is noted that the idea of coverage units suspension under view B has not been sufficiently explored.

In relation to view B:

- Within View B, extending coverage of the LIC may create some conflict with other areas of the standard, i.e. the reconciliation of claims development and the LIC and its knock-on effect for PAA model (paragraphs 100 and 130). It would also potentially create an extremely long contract boundary for non-life products as these products generally have uncertain claims.

In relation to view A:

- The analogy of consequential insurance risk with paragraph B5 makes more sense in the context of an acquisition, not in running a business. This is because

in writing any policies, an entity arguably already estimates the pre-existing risks of adverse developments and uncertain claims.
- Extending the liability for remaining claims from a stand-ready obligation for consequential risk to occur, to a stand ready obligation for consequential risk to diminish; seems to extend the liability for remaining claims indefinitely. That is, when does the insurer recognize the incurred claim?

AP02: Determining discount rates using a top-down approach
Members agreed with the IASB staff view, which is that changes in the assets held could impact the discount rate, subject to the relevant 'top-down' adjustments (which include an adjustment for differences in liquidity characteristics of the insurance contract and the reference portfolio).

The following concerns were raised:
- Paragraph 20 of the staff paper (IFRS 17 paragraph BC196(a)—the criteria for the simplification i.e. entities are permitted to not adjust the yield curve derived from a reference portfolio of assets for differences in liquidity characteristics of the insurance contracts and the reference portfolio) is unclear.
- The discussion on the impact of changes in the reference portfolio to the discount rate may also applicable for the bottom-up approach which would have different illiquidity spreads for the reference portfolio. Since the simplification is permitted for the top-down approach but is silent for the bottom-up approach; would this in effect create more differences between the top-down and bottom-up approach?

In terms of deriving the discount rate via the top-down approach, some members commented that:
- Entities should refer back to the objective of the discount rate in IFRS 17 paragraph 36.
- All adjustments arrived at to derive the discount rate must be justifiable, supportable and documented.
- The top-down approach may not be a common approach selected by companies in Hong Kong and hence not a big issue. If it is applied, the more material adjustment in applying the top-down approach is likely to be the stripping out of credit risk and other risk factors related to the asset reference portfolio, rather than the liquidity characteristic.
- The end result from the bottom-up and top-down approach in deriving the discount rate should theoretically be fairly similar.

In terms of the issue discussed in the submission, some members questioned why it was not a rejected submission, as they considered the standard to be clear.

AP03: Commissions and reinstatement premiums in reinsurance contracts issued

Members agreed with most of the staff views presented in the paper. A few members were supportive of the requirement, noting that it better reflects the economic substance of the transactions and provides better information to users of the financial statements.

The following concerns were raised:
- One member observed that it seems like the timing of when the ceding commission is paid impacts the determination of whether it is an investment component—i.e. if it is paid upfront it is not an investment component. Another member responded that the key indicator is actually whether the ceding commission is refundable or not.
- One member noted that the staff paper draws an analogy to the accounting for reinsurance with the accounting for reinsurance contracts held. The member questioned if this made sense, and if so, if a clarification is required so that it is clear to everyone that this analogy should be applied by reinsurers. Furthermore,

presentation requirements allow a net presentation for reinsurance contracts held. It is not clear that this is the IASB's intention for reinsurance accounting.
- Another member noted that paragraph 27 of the staff paper states that the ceding commission paid by the reinsurer to the cedant is not an acquisition cost of the reinsurer. This means that this ceding commission would need to be recognized by the reinsurer at once and not deferred as an acquisition cost, which potentially may result in some onerous contracts for reinsurers.
- It could be operationally difficult to implement and represents a change from current practice. Another member commented that this change in the presentation of commissions would likely impact taxation.
- Paragraph 58 of the staff paper states that the reinstatement premium and related cash flows are within the boundary of the initial contract as the reinsurer has no right to exit or reprice the contract. One member notes that for clarity, this statement should be more clearly linked to previous IASB TRG meeting outcomes on reflecting the practical ability to renew.

AP04: Premium experience adjustments related to current or past service

A few members commented that it is not easy to separate premiums related to future / past services. For example, in a limited pay whole life contract where premiums are paid evenly for 5 years, after 3 years it is difficult to differentiate if it is related to past or future services.

A few other members also questioned how premium experience adjustments related to current or past services should be applied and reconciled with IFRS 17 paragraph 106. It was questioned if a minor amendment via the Annual Improvements Process is necessary so that it is clear where and how these adjustments should be disclosed, for example, if a separate category is required or if it should be broken down into the categories specified in IFRS 17 paragraph 106.

AP05: Cash flows that are outside the contract boundary at initial recognition

A few members commented that operationally it would be a nightmare to create a new contract every 3 months. Furthermore, they commented that disaggregating one contract into different components is not consistent with how the claims are settled. For example, claims on a contract are usually settled in one go, not split into four. These members struggled to agree with the IASB's thinking.

A few other members are supportive of this change as it allows:
- room for an updated discount rate. This is because the general measurement model prescribes a locked-in discount rate for the CSM. Therefore, by recognizing a new contract every 3 months, it allows the discount rate to be updated.
- mitigates the requirement from a previous IASB TRG meeting outcome to project expected future new business and incorporate it in the measurement. This way, the projection only needs to be for a period of 3 months.

One member observed that the grouping in terms of onerous, not onerous, etc may change after reassessment every 90 days.

One member questioned the interaction between this submission and that of Submission 75 in AP11 which concludes that the boundary of a reinsurance contract and insurance contract is the same.

One member noted that the IFRS 17 paragraph B64 is too narrow in its consideration, and that it should not only be based on the practical ability to reprice by the insurer. For example, it should also consider the life of the policyholder.

AP06: Recovery of insurance acquisition cash flows

Example 6 (paragraph C10 of the staff paper) was discussed by members:

- A few members noted that it seemingly contradicts IFRS 17 paragraph B120 and B96(a)) as an acquisition cost for current or past service shouldn't adjust revenue. Again, it is unclear where this adjustment would be reflected per the requirements of IFRS 17 paragraph 106.
- One member noted that it does not contradict IFRS 17 requirements if the adjustment is viewed from the perspective of a reallocation of premium.
- Classifying the acquisition cost is for current or future services may not be too simple. The staff paper seems to imply it is based on the timing of when it is settled.

In general, members agreed that there seems to be a gap in terms of clarity of where any adjustments in the insurance acquisition cost should be recognized, and why. For example: if it impacts CSM—why and how it should be reconciled with paragraph 106.

Regarding paragraph 23 of the staff paper, a few members noted that the clarification of the application of IFRS 17 paragraph 65(h) on trade commissions may cause some concern. This is because it assumes that all trade commissions are maintenance expenses. However, a few members noted that economically, they are acquisition in nature (i.e. for selling). However, another member questioned what should be the criteria for companies to figure out what is a post placement maintenance service, versus, what is in substance a selling expense for acquisitions? For example, agents who receive trade commissions do not typically have any obligations to deliver a service.

AP07: Premium waivers

One member questioned paragraph 15(b) of the staff paper. That is, whether a waiver premium would actually impact the coverage units (based on the literal definition of coverage units). This is because the amount payable to policyholders is the same even when there is a premium waiver. Therefore it could be argued that the waiver should not impact the coverage units, which is dependent on the maximum amount payable to the customer.

Other members commented that it would impact coverage units because the policyholder actually paid for the 'premium waiver' rider in the first place, and this rider already generates a CSM. Therefore, it would impact coverage units.

A few members questioned how these premium waivers would then be reconciled to the insurance revenue recognized.

AP08: Group insurance policies

In general, there is no disagreement on the staff views although it was noted that the fact pattern is specific and narrow.

Regarding the identification of the insurance contract; one member noted that the staff paper clearly articulates that the policyholder of group policies is the individual certificate holders, unless it can be overrided. This member noted that although this is a change from current practice, paragraph 20 of the staff paper is helpful guidance to perform an assessment of the lowest unit of account in these cases.

Regarding the determination of the boundary of an insurance contract; one member noted that if contracts have a generic 90 day renewal clause, it would change the contract boundaries for group policies into short term.

AP09: Industry pools managed by an associate

No major comments were raised.

AP10: Annual cohorts for contracts that share in the return of a specific pool of underlying items
Members discussed examples 1 and 2 (paragraphs A3 to A15 of the staff paper).

Members observed that the staff paper seems to imply that only contracts which share in 100% of the risks & returns will result in a measurement of contractual service margin at a higher portfolio level which is the same as that as the annual cohort level (i.e. view A of the staff paper).

Members generally disagreed with this and commented that where there is not 100% sharing in example 2 of the staff paper—such as in paragraphs A13, A14 and A15 of the staff paper—they all still result in the same overall net cash flows. Therefore, it should be allowed that the requirement in paragraph B68 is applicable to all mutualised contracts, as long as the requirements for a loss component are still met (i.e. view B of the staff paper).

It was also noted that coming up with the adjustment required by paragraph B68 would be operationally complex.

A few members questioned why the loss recognized for Group 1 could not be mutualised with other profitable groups in A14 and A15.

AP11: Reporting on other questions submitted
In particular, members noted the IASB staff response to Submission 73 did not seem to answer the question in the submission.

Action/Conclusion
IASB TRG members will communicate HKIISG concerns at the September IASB TRG meeting.