Hong Kong Institute of Certified Public Accountants – Insurance Implementation Support Group (IISG)

Note on certain considerations following the debate of the IISG on agenda paper 03 at the meeting held on 26 July 2018.

The discussion of agenda paper 03 resulted in the conclusion that there are other scenarios where the financial statements of an insurer would carry a permanent difference in the OCI treatment of insurance contracts compared to the OCI treatment of financial assets that are accounted for at fair value through OCI under IFRS 9.

This note captures these scenarios to aid the IISG goal to aid the application of HKFRS 17 in the Hong Kong market.

Scenario 1 – post transition for VFA contracts when the insurer reclassifies financial assets under IFRS 9.

This scenario requires the consideration of two factors to understand the potential for a permanent OCI difference to be reported in the financial statements of the insurer:

a) Which reclassification occurs out of those covered in section 5.6 of IFRS 9; and
b) Whether the insurer changes its accounting policy for presentation of the insurance finance income or expense from the policy set out in IFRS 17 paragraph 89(a) to paragraph 89(b) or vice versa

IFRS 9 RECLASSIFICATION	A – CHANGE FROM 89(A) TO 89(B)	B – CHANGE FROM 89(B) TO 89(A)	IS THERE A PERMANENT OCI DIFFERENCE IN THE FINANCIAL STATEMENTS?
FROM AMORTISED COST (AC) TO FAIR VALUE THROUGH PROFIT OR LOSS (FVTPL) – PARAGRAPH 5.6.2 OF IFRS 9	The change in the policy is not consequential given the application of the policy under 89(b) results in the same presentation of insurance finance income or expense.	The accounting treatment of the accumulated OCI balance under 89(b) is to be restated through retained earnings in the opening balance sheet while the reclassification accounts for the	There is no permanent difference as at the end of the period when the change in accounting policy and the reclassification have been reported. However, there could be mismatch in the statement of comprehensive

IFRS 9 RECLASSIFICATION	A – CHANGE FROM 89(A) TO 89(B)	B – CHANGE FROM 89(B) TO 89(A)	IS THERE A PERMANENT OCI DIFFERENCE IN THE FINANCIAL STATEMENTS?
		cumulative unrealised and unrecognised gain or loss in the profit or loss statement of the period when the reclassification takes place.	income between items reported in profit or loss and those reported in other comprehensive income due to the prospective vs. retrospective treatment required by the two IFRS.
FROM FVTPL TO AC – PARAGRAPH 5.6.3 OF IFRS 9	The insurer will create a difference in OCI as it is always the case when financial assets/underlying items are measured at AC.	There would not be an OCI difference given the change in the IFRS 17 policy.	The difference between the insurance contracts and the underlying items will persist in retained earnings (from column B) and in accumulated OCI (from column A) up to the date of derecognition of the underlying items at AC. The difference is thus not permanent.
FROM AC TO FAIR VALUE THROUGH OTHER COMPREHENSIVE INCOME (FVOCI) – PARAGRAPH 5.6.4 OF IFRS 9	The IFRS 17 restatement and the effect of reclassification would align the accumulated OCI balance at the end of the period when these are accounted for.	Although is likely to be an unrealistic scenario it should be noted that a temporary difference in the accumulated OCI for the underlying items and retained earnings for the insurance finance income or expense is created by policy change.	At the end of the period when the reclassification and the change in policy are done, there is no difference (from column A) or a temporary difference is created by policy election (column B). The difference is temporary because the accumulated OCI for the underlying items would recycle.
FROM FVOCI TO AC – PARAGRAPH 5.6.5 OF IFRS 9	Same as the effect from the reclassification under paragraph 5.6.3 of IFRS 9	Same as the effect from the reclassification under paragraph 5.6.3 of IFRS 9	Same as the effect from the reclassification under paragraph 5.6.3 of IFRS 9
FROM FVTPL TO FVOCI – PARAGRAPH 5.6.6 OF IFRS 9	In this case the restatement required under the change to the policy set out in paragraph 89(b) creates an opening accumulated	The policy change creates a difference going forward. The restatement of the prior accumulated OCI in retained	This combination creates a permanent difference. The combination from column A is the one that is more likely to occur in

IFRS 9 RECLASSIFICATION	A – CHANGE FROM 89(A) TO 89(B)	B – CHANGE FROM 89(B) TO 89(A)	IS THERE A PERMANENT OCI DIFFERENCE IN THE FINANCIAL STATEMENTS?
	OCI balance that is not matched by having a similar balance for the underlying items.	earnings aligns the accounting to the treatment of the underlying items after the reclassification because they would be both included in the retained earnings. However, the recognition of insurance finance income or expense in profit or loss creates a temporary difference that would be eliminated only when recycling of gains/losses takes place. The presence of non-recyclable gains/losses will create a permanent OCI difference.	practice and the difference is caused by the IFRS 17 requirements on recycling set out in paragraph 91(b). The difference from the combination in column B is caused by the recycling requirements of certain underlying items (equity instruments).
FROM FVOCI TO FVTPL – PARAGRAPH 5.6.7 OF IFRS 9	Same as the effect from the reclassification under paragraph 5.6.2 of IFRS 9	Same as the effect from the reclassification under paragraph 5.6.2 of IFRS 9	Same as the effect from the reclassification under paragraph 5.6.2 of IFRS 9

In all of the reclassification scenarios that correspond to the changes of the IFRS 17 accounting policy set out in column A, the insurer had not previously reported in OCI any amount of insurance finance income or expense from its VFA insurance contracts.

The OCI difference would arise from having accounted financial assets at FVOCI while insurance finance income or expense is fully recognised through profit or loss. Some of the combinations are thus a mere illustration of the treatment that would be the treatment even if they may not be necessarily be found in the real world.

Similarly for the changes set out in column B there are combinations that are unlikely to be found in the real application of IFRS 17 and IFRS 9 and their inclusion in the table is for completeness and illustration purposes only.

Scenario 2 – post transition for contracts under the IFRS 17 general measurement model when the insurer reclassifies financial assets under IFRS 9.

The consideration and consequences above are mitigated for contracts under the general measurement model by the different IFRS 17 recycling of the accumulated OCI balance set out in paragraph 91.

This paragraph (see paragraph 91(b)) prohibits the recycling of accumulated OCI balances recognised from the application of the policy set in paragraph 89(b). This means that when the associated OCI balance in the underlying items can be recycled the insurer may have differences from retained accumulated OCI balance on the insurance contracts side that could be eliminated only when the underlying items and the associated insurance contracts are derecognised in full. This complete settlement of the portfolio and of its associated underlying items may occur over a very long time period and the difference, although technically temporary, may be reported for a protracted period.

For insurance contracts that are accounting for the insurance finance income or expense using the approaches set out in paragraph 88(b) of IFRS 17 the recycling is not constrained and it would follow the natural derecognition of insurance contracts (see paragraph 91(a)). Any difference would be temporary and it would disappear over time as the portfolio of insurance contracts and the underlying items churn.

Francesco Nagari

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