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

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25 September 2019

Mr Hans Hoogervorst
International Accounting Standards Board
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

Dear Hans,

IASB Exposure Draft ED/2019/4
Amendments to IFRS 17

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to set and promulgate standards relating to financial reporting, auditing and ethics for professional accountants, in Hong Kong. We are grateful for the opportunity to provide you with our views on this Exposure Draft (ED).

The HKICPA is overall supportive of the Board's efforts to respond to IFRS 17 implementation concerns, and agrees with the ED's objective to propose amendments that will not result in a significant loss of useful information and avoid unduly disrupting implementation already underway. In particular, we would like to thank the Board for considering the pattern of contractual service margin (CSM) allocation for insurance contracts without direct participation features which have investment components, and also the treatment of reinsurance contracts held where underlying insurance contracts are onerous on initial recognition. These were both top technical issues for our stakeholders, which the HKICPA recommended the IASB staff to consider as proposed amendments in October 2018.

The HKICPA generally agrees with the principles of the proposed amendments, and our comments focus on suggested refinements and clarifications. The primary issues which we focus on for comment are:

1. Expected recovery of insurance acquisition cash flows. Particularly, we recommend that guidance is provided on discounting and comment on a number of interpretation issues including treatment when applying the premium allocation approach (PAA).
2. CSM attributable to investment-return service and investment-related service. In particular, the definition of investment-return service, the identification of coverage units and weighting of benefits.
3. Reinsurance contracts held–recovery of losses on underlying insurance contracts. Our key issue here is the definition of *reinsurance contracts held that provide proportionate coverage*, and the scope of reinsurance arrangements that will qualify for the proposed accounting treatment.

4. Effective date. We especially seek to emphasise the importance of a consistent timeline for global adoption.
5. An unsolicited edit was made to ED.B107(b)(i), which we recommend be reversed and clarified.

Summaries of our stakeholders' main comments and the HKICPA's detailed responses to the questions raised in the ED are in the Appendix.

If you have any questions regarding the matters raised in this letter, please contact me or Tiernan Ketchum (tiernanketchum@hkicpa.org.hk), Associate Director of the Standard Setting Department.

Sincerely,

Christina Ng
Director, Standard Setting Department

Encl.

Work undertaken by HKICPA in forming its views

The HKICPA:

(a) issued an Invitation to Comment on the ED on 27 June 2019 to our stakeholders;
(b) hosted industry roundtables on 4 – 5 July 2019, and investor sessions on 3 July 2019;
(c) sought input from its Hong Kong Insurance Implementation Support Group comprising technical and industry experts, and auditors from accounting firms; and
(d) developed its views through its Financial Reporting Standards Committee, having reflected on its stakeholder feedback. The Committee comprises of academics, preparer representatives from various industry sectors, investors, regulators, and technical and industry experts from small, medium and large accounting firms.

This submission outlines the HKICPA's views and summarises our stakeholders' primary comments on the ED. As requested in the ED, we have limited our comments to matters addressed in the proposals.

Detailed comments on IASB ED/2019/4

Question 2—Expected recovery of insurance acquisition cash flows (paragraphs 28A–28D, 105A–105C, B35A–B35C and BC31–BC49)

Stakeholders' views

1. Our stakeholders are generally supportive of the overall principle of extending the recognition of an asset for acquisition cash flows to amounts allocated to expected renewals, and of requiring a recoverability assessment.

Discounting

2. Several stakeholders raised concerns that there is a lack of guidance around discounting the expected net cash inflow for the group in ED.B35B(a), including whether discounting is required, and if so, what discount rates should be used. Some stated that the proposals are unclear on whether the time value of money should be considered, and could be interpreted to require discounting using the rate present at initial recognition of the group. Some stakeholders emphasised it is pertinent to have further guidance on this topic given that the discounting approach will materially affect the impairment assessment. Some stakeholders expressed a preference for discounting being required, and for the Standard to specify that current discount rates be used.

3. A couple stakeholders questioned whether discounting of the asset for insurance acquisition cash flow itself would be required. These stakeholders expressed diverging views on whether it should be.

Interaction with the PAA

4. Some stakeholders requested clarity around whether entities applying the PAA would always be required to allocate acquisition cash flows under these proposals, or whether they would have an accounting policy choice to expense all acquisition cash flows, including those related to renewals, when incurred in line with IFRS 17.59(a).

5. One stakeholder contended that the drafting of ED.28A implies that there is the option to expense the acquisition cash flows even if they relate to future groups of contracts. This stakeholder argued that this implication would be inconsistent with IFRS 17.59(a), which allows an entity applying the PAA to choose to recognise acquisition cash flows as expenses when it incurs those costs for groups of contracts with coverage periods of one year or less. Under this view, an asset for insurance acquisition cash flows related to expected groups of contracts should be recognised in all cases, and IFRS 17.59(a) should apply only after the allocation of cash flows has been performed under ED.B35A. As such, this stakeholder proposed that ED.28A be clarified to state that an entity applying the PAA may only recognise acquisition cash flows as expenses after they are allocated to a group. This stakeholder further argued that not requiring allocation of the acquisition cash flows for entities applying the PAA would negatively affect the comparability of entities.

6. Some stakeholders observed that a requirement to allocate acquisition cash flows in all cases including the PAA could be operationally burdensome, specifically for non-life insurers.

Disclosure

7. Some stakeholders expressed concern about the disclosure requirement proposed in ED.105B, in particular, that it could result in the disclosure of commercially sensitive information which could also lack usefulness and be subject to misinterpretation by users. One stakeholder stated that the disclosure would be operationally burdensome. However, some user stakeholders expressed a desire to have clear disclosure of the allocation of acquisition cash flows and the ability to understand management's allocation process over time.

Other interpretation issues

8. One stakeholder questioned whether any guidance could be provided for the term *expected* when assessing whether insurance contracts are expected to arise from renewals in ED.B35A.

9. Some stakeholders questioned whether the term *paid* in ED.28B(b) should be interpreted as amounts settled or include amounts payable. A few stakeholders mentioned that it was common for entities to pay fees over time, and expressed a preference for being able to deem fees payable as *paid*.

10. One stakeholder stated that the guidance in ED.28B(b) is unclear on how an acquisition cash flow that relates to multiple future groups should be accounted for (e.g. whether for a group of contracts that is expected to renew each year, one asset should be recognised for each future renewal (multiple assets) or one asset recognised for all future renewals).

HKICPA analysis and recommendation

11. The HKICPA is supportive of this proposal overall. We agree with the Board's rationale that allocating insurance acquisition cash flows to expected renewals of contracts provides useful information.

Discounting

12. The HKICPA suggests clarifying the requirements on discounting the expected net cash inflows, given it has engendered confusion among some preparers. The expected net cash inflows act as a key input for the impairment model, and hence it is important that the Standard be clear as to how they should be measured. We think that the measurement of net cash inflows should be on a discounted basis, consistent with IFRS 17's overall approach to reflect the timing of cash flows in measurement, and that the discount rates used should be representative of the current term structure of interest rates. We consider that this is already governed by IFRS 17.32, 36 and B72; however, given the interpretation issues raised by our stakeholders we recommend that the drafting be clarified. Specifically, two points should be clarified:

    a. Whether discounting of the expected cash inflows is required. We think that it should be.

    b. If discounted, the rate that should be used. We think that the current discount rate should be used in line with IFRS 17.36. We note that the current discount rate should be representative of the appropriate point in time along an appropriate yield curve.

13. Further, we note that the terms *net cash inflow* and *expected net cash inflow* in ED.B35B are not used elsewhere in the Standard. Although ED.B35B(a) refers the reader to IFRS 17.32(a), that paragraph and related guidance do not use the term *net cash inflow* or *expected net cash inflow*, and we think that this drafting is imprecise. We recommend the Board make clear in its drafting what is being referred to here and ensure the wording is aligned with the rest of the Standard.

Interaction with the PAA

14. We note that the PAA was implemented to provide simplified liability measurement, and that the option in IFRS 17.59(a) to recognise acquisition cash flows as expenses when incurred currently results in an entity being able to avoid recognising an asset or liability for these cash flows (which is made clear in IFRS 17.27).

15. We consider that the drafting in ED.28A would grant entities a policy choice to expense acquisition cash flows when incurred before applying the allocation requirements in ED.B35A. We observe that this choice is consistent with the current requirements of IFRS 17 that enable an entity applying this option in the PAA to expense acquisition cash flows as incurred and hence not recognise an asset or liability.

16. We note the view of some of our stakeholders that not allocating acquisition cash flows when applying the PAA may result in comparability issues, however we

think that the guidance as drafted is clear and consistent with the intention of the Board to provide simplification for the subset of contracts with coverage periods of one year or less under the PAA. The purpose of the PAA is to provide a simplified approach that is a reasonable approximation of the general model, and hence requiring entities to allocate acquisition cash flows and recognise an asset would conflict with this objective. We also note that the PAA approach, by definition being an approximation, already affects comparability in and of itself. As such, we do not recommend that this optionality be removed.

17. We nevertheless would allow the Board to consider our stakeholder feedback as to whether the extension of the requirements should trigger a broader reassessment of the optionality provided under the PAA.

<u>Disclosure</u>

18. The proposals include further disclosure requirements for the asset for insurance acquisition cash flows that we think will be useful and respond to user feedback. We also note that some users indicated a desire to understand management's rationale for allocation of acquisition cash flows, and recommend that the Board ensure that disclosure requirements are robust. With regard to the proposed disclosure in ED.105B, we acknowledge the Board's rationale for the requirement as noted in ED.BC46. However, we recommend the Board holistically consider what this disclosure is trying to achieve and the feedback received on the cost constraint.

<u>Other interpretation issues</u>

19. We would also draw the Board's attention to a number of interpretation issues:

    a. The term *expected* in context of assessing whether insurance contracts are expected to arise from renewals (ED.B35A). There is presently no guidance to determine whether an insurance contract would qualify to be considered expected to arise and some stakeholders requested further guidance on this point. However, the HKICPA notes that the term *expected* is common throughout IFRS in myriad contexts, and so we do not recommend adding specific guidance given the risk of creating an arbitrary dividing line.
    b. The term *paid* in ED.28B(b) does not specify whether this should be interpreted as settled amounts or amounts payable. A similar issue was discussed by the TRG in February 2018 with respect to the phrase "*premiums, if any, received*" in IFRS 17.55(a) and 55(b)(i). We suggest the Board clarify in the Standard whether *paid* should be interpreted as "cash paid" or "cash paid and payable". In doing so, it would not be desirable to see an arbitrary gross-up of assets for insurance acquisition cash flows for the insurance industry compared to other preparers (under IFRS 15), and as such, the requirements of other Standards (namely IFRS 9 and the overall accounting for executory contracts) should be taken under consideration.
    c. The wording "*existing … group*" in ED.28B(b) is confusing as it implies the group is recognised, however one would expect an acquisition cash

flows asset for a recognised group to have been derecognised in line with ED.28C.

Question 3—Contractual service margin attributable to investment-return service and investment-related service (paragraphs 44–45, 109 and 117(c)(v), Appendix A, paragraphs B119–B119B and BC50–BC66)

Stakeholders' views

20. Our stakeholders are supportive of the overall principle of the proposed amendment and the concept of recognising the contractual service margin (CSM) over a period that considers investment-return services for contracts without direct participation features. The majority of our stakeholders agreed that the existing CSM recognition principles for insurance contracts without direct participation features that provide an investment service did not appropriately represent the service provided under the contract. The existing treatment could additionally result in the front-loading or back-loading of revenue and create structuring opportunities. There was also general consensus among our user stakeholders that economically similar contracts should have comparable accounting treatment. These stakeholders hence welcome the Board's proposals.

<u>Definition of investment-return service and investment-related service</u>

21. Several stakeholders commented on the definition, or lack thereof, of *investment-return service* and the criteria in ED.B119B. These stakeholders remarked that the criteria in B119B appear restrictive and rules-based, and could result in various contracts that are considered in practice to be providing investment services failing the criteria. A few stakeholders stated they were confused as to the rationale for having different terms for contracts without direct participation features (*investment-return service*) and for contracts with direct participation features (*investment-related service*), and what precisely the differences are between the two terms.

22. With regard to ED.B119B's specific criteria, some stakeholders commented that criterion B119(a) was acceptable, criterion B119(c) would nearly always be met, and that criterion B119(b) was confusing and appeared too restrictive. Some stakeholders commented that the rationale for using the term "*positive investment return*" in ED.B119B is unclear regarding how a positive investment return should be assessed, and why the word "positive" is used at all.

23. Some of these stakeholders offered suggestions how the definition of *investment-return service* may be improved. One stakeholder recommended ED.B119B should clarify that such contracts provide an investment-return service if the policyholder expects to receive a return from the contract and is being provided a service not otherwise available to the policyholder.

24. Another stakeholder commented that "incidental" investment-return services should be specifically excluded from the scope of the definition. An example of a product with such services that some stakeholders would *not* want to see captured by ED.B119B is a whole of life protection policy with pay-out on death that has a cash surrender value (which may be required by local regulations).

This cash surrender value would be very low at first, but could build up such that at certain, later years in the product life cycle, it would be marginally more than premiums paid in. The cash surrender value in such cases could be viewed as generating a positive investment return and cause the product to fall under ED.B119B. However, the stakeholders argue that the cash surrender value is not a core part of the service being provided under such products and is not intended to make the contract a savings product. As such, they would consider it inappropriate for that feature to affect the profit emergence pattern.

25. One stakeholder suggested a definition utilising the guidance currently in IFRS 17.B75. Paragraph B75 notes that "B74(b) requires cash flows that vary based on the returns on underlying items to be discounted using rates that reflect that variability, or to be adjusted for the effect of that variability and discounted at a rate that reflects the adjustment made. The variability is a relevant factor regardless of whether it arises because of contractual terms or because the entity exercises discretion, and regardless of whether the entity holds the underlying items." The existence of this variability, made manifest through the requirements of paragraphs B74-B75, could prove that the contract in question is providing an investment-return service. A definition could hence be formulated that described an investment-return service to exist when the contract has cash flows that vary based on the returns of underlying items.

<u>Identifying coverage units and weighting</u>

26. Several stakeholders commented that identifying coverage units and determining the amount of the CSM to recognise in profit or loss in each period remains an implementation challenge. This is particularly the case for contracts involving complex blends of multiple and heterogeneous services, and contracts with long durations and back-ended cash flow profiles. These stakeholders commented that both the existing requirements and proposals provide little direction on what type of approach should be applied. Some of these stakeholders stated there was insufficient guidance to assess whether coverage units should be calculated with reference to the dollar amount of the underlying assets (e.g. the AUM or asset share), the coverage or surrender value, or the passage of time, et cetera. It was expressed that such lack of guidance could result in diversity in practice. One stakeholder recommended that a practical expedient (e.g. a straight-line method) be provided for contracts with complex blends of multiple services.

27. Some stakeholders commented that weighting the various services would be complex and demanding. Some also questioned the usefulness that the disclosure of the relative weighting of benefits would provide to users, and commented that a lack of guidance on how to perform the weighting would result in incomparability between entities. Some stakeholders noted that further guidance allowing unbundling could be beneficial, and suggested that further principles could be constructed from the TRG discussions on separation of a single contract in February 2018. One stakeholder recommended against such an unbundling approach as it could trigger a broader need to reconsider the requirements in IFRS 17, and suggested that the Board provide more practical solutions.

HKICPA analysis and recommendation

28. The HKICPA appreciates the Board's efforts to address this issue, which the HKICPA also recommended IASB staff to consider as a proposed amendment to IFRS 17. We consider that amending the general model so that the CSM is recognised in profit or loss on the basis of coverage units that are determined by considering both insurance coverage and investment services will provide useful information about the services provided, as noted in ED.BC56, and enhance IFRS 17's faithful representation. However, we have made some suggestions to improve the proposal below.

<u>Definition of investment-return service and investment-related service</u>

29. The HKICPA notes that that the drafting of the terms of *investment-return service* and *investment-related service* has raised questions among our stakeholders. The HKICPA understands the Board's rationale for proposing a distinct concept termed an "investment-return service" is to distinguish this category from contracts under the variable fee approach.

30. We do however note that the proposed guidance has engendered interpretation issues. In particular, the guidance has raised questions concerning: (1) the difference between the two terms, which is not clearly explained in the body of the Standard; and (2) the perceived restrictiveness and rule-based nature of the ED.B119B criteria.

31. We find it somewhat challenging to the reader that such concepts are not clearly defined in ED, for example within Appendix A. The current drafting does not present a direct definition of *investment-return service* nor *investment-related service*. While a rough understanding could presumably be derived from the definition of *insurance contract services, insurance contract with direct participation features* and the Basis for Conclusions, it is not accessible or user-friendly and its lack may cause confusion. We hence suggest to define *investment-related service* and *investment-return service* in the body of the Standard (e.g. Appendix A).

32. The HKICPA recommends that the Board reflect further on how these categories can be demarcated and defined. We suggest the following for your consideration:

    a. Defining *investment-related service* and *investment-return service* clearly in the body of the Standard (e.g. Appendix A) as noted above.
    b. Clarifying in the body of the Standard that the existence of an *investment-return service* is a matter of judgement and that the criteria presented in ED.B119B are not determinative. This appears to be explained in ED.BC60, but the drafting of ED.B119B is ambiguous (particularly in the use of the discordant phrase "<u>*may*</u> *provide an investment-return service* <u>*if, and only if*</u>*: …*").
    c. Replacement of ED.B119B(b)-(c) with an apophatic component to define *investment-return services* by what they are not. This may help resolve the difficulties faced in positively defining an investment-return service and the concerns raised by stakeholders that have arisen since the IASB Staff's proposal to include the B119B criteria in the May 2019 IASB meeting (Agenda Paper 2C). For example:

B119B Insurance contracts without direct participation features may provide an investment-return service if, and only if:

(a) an investment component exists, or the policyholder has the right to withdraw an amount; <u>*and*</u>

(b) <u>*a significant portion of the services that may be provided to the policyholder do not relate to insurance coverage.*</u>

33. The HKICPA has noted stakeholder feedback that "incidental" investment-return services should be excluded from the scope of the definition. We consider that one motivation for this would be to avoid instances of structuring where non-genuine clauses could be included to alter the coverage unit profile. We would suggest pertinent guidance may exist in IFRS 17.B18, which excludes scenarios that have "*no commercial substance (ie no discernible effect on the economics of the transaction)*" from affecting the assessment of significant insurance risk. The Board could clarify that this notion extends to assessing if an investment-return service is present.

<u>Identifying coverage units and weighting</u>

34. We also note that the comments raised by our stakeholders on the challenges of identifying coverage units and allocating the CSM to profit or loss are not new to the proposals in the ED. IFRS 17.BC279-BC283 contains rationale as to the Board's intentions on the matter, and the issue was discussed at the TRG in February and May 2018, during which time the TRG members observed that:

- IFRS 17 established a principle to reflect services provided in a period rather than detailed requirements. The determination of coverage units involves judgement and estimates, which should be applied systematically and rationally.
- Coverage units reflect the likelihood of insured events occurring only to the extent they affect the expected duration of contracts, and do not reflect the likelihood of insurance events occurring to the extent they affect the amount expected to be claimed.
- The period in which an entity bears insurance risk is not necessarily the same as the coverage period. Expectations of lapses of contracts and different levels of service should be considered in determining coverage units.
- Entities should consider the benefits expected to be received by the policyholder rather than the expected costs of providing those benefits when determining the quantity of benefits provided. Policyholders benefit from the entity standing ready to meet claims, and hence the quantity of benefits provided relates to amounts that can be claimed by the policyholder.
- IFRS 17 does not specify a particular method to determine the quantity of benefits and different methods may achieve the objective. Reasonable proxies may include:
  - Straight-line allocation over the passage of time (reflecting the number of contracts in a group).
  - Methods based on the maximum contractual cover or the amount the policy holder is expected to be able to claim in each period.
  - Methods based on premiums or on expected cash flows.

35. The HKICPA supports a principle-based approach to allocating the CSM, and we consider, as noted by the TRG above, that IFRS 17 has provided the principle on how to do so. Preparers should apply appropriate judgement and estimates to best achieve that principle. We do however recommend that the Board give thought to the most appropriate way to explain this principle to preparers, and examine whether the TRG guidance summarised above can be incorporated more formally into the Standard. We suggest this could be done in the form of examples in the guidance accompanying IFRS 17, and through educational materials. Doing so will support the implementation process and help allay concerns of diversity in practice.

36. The HKICPA appreciates the comments made by our stakeholders with regard to the complexity of weighting the CSM. However, the HKICPA also notes (as did some of our stakeholders) that this complexity exists for contracts under the variable fee approach and contracts with more than one type of insurance coverage under the general model. We are of the view that the benefit of the resulting information, including the proposed disclosures, outweighs these considerations. We agree with the rationale in ED.BC62 that it is sufficient that the allocation be made on a *systematic and rational* basis, and suggest that this be made clear in the body of the Standard. We also suggest that it may be helpful if the Board were to develop educational materials on this topic.

Question 4—Reinsurance contracts held—recovery of losses on underlying insurance contracts (paragraphs 62, 66A–66B, B119C–B119F and BC67–BC90)

Stakeholders' views

Definition of reinsurance contract held that provides proportionate coverage

37. Our stakeholders' generally support the objective of this proposed amendment; however, many stakeholders raised concerns about the proposed definition of *reinsurance contract held that provides proportionate coverage*. These stakeholders think that the definition is overly restrictive, such that certain commonly used reinsurance contracts that are considered by the industry to provide proportionate coverage would fail the definition. As a result, they assert that the proposals are of limited value, fail to achieve the stated objective, and exacerbate comparability issues as similar reinsurance contracts and entities with similar reinsurance arrangements become subject to differing treatment.

38. In particular, the current drafting in the definition and ED.B119C draws a hard line as to what qualifies as proportionate, and may result in only a limited selection of full (first dollar) quota share reinsurance arrangements of the full scope of a group of underlying insurance contracts meeting the definition. To illustrate, consider the following points concerning two common forms of proportionate (or pro rata) reinsurance: quota share and surplus share.

    a. Quota share reinsurance indemnifies the cedent for a fixed percentage of loss, but these treaties may only have selected types of risks reinsured, or exclude certain risks from coverage (e.g. a reinsurance arrangement that excludes dividend cash flows).

b. Quota share reinsurance may only be applicable to the net amount at risk instead of total cash flows, and hence be a fixed percentage of the net amount at risk but a variable percentage of the total sum insured over the life of the policy.
c. It is common that reinsurance arrangements will result in the cedent retaining a portion of risk. This may be seen both in quota share arrangements and in surplus share reinsurance contracts which involve the ceding of a proportion of a liability on a given risk above a retention.

39. These and other prevalent forms of reinsurance may fail to meet the proposed definition.

40. Furthermore, not all underlying insurance contracts in a group may be covered by the same ceding percentage. Stakeholders noted that entities may have proportionate reinsurance arrangements where terms are defined differently on an individual contract level, such that while being individually fixed, they would not be considered "fixed" on a group level. Stakeholders noted that if the proposals require that the proposed definition is applied at the group level, this could result in forced grouping of contracts based on applicable reinsurance treaties. This could also result in facultative reinsurance arrangements not being eligible for the approach. Stakeholders note this would be a disagreeable outcome both from an operational perspective and in terms of the faithful representation of industry practice.

41. Similar to the above, one stakeholder questioned whether the proposals require all contracts within a group to be covered by reinsurance for the guidance to be applicable. This stakeholder stated that there may be cases in practice where certain contracts within a group are not covered by reinsurance, and thinks that the proposals should still be applicable to such cases.

42. Rather than referring to a "*fixed percentage of claims*", some stakeholders suggested that introducing the terms "*contractually defined percentage*" or "*a fixed percentage of ceded claims*" would enable a more appropriate scope of reinsurance arrangements to qualify under the proposals.

43. One stakeholder also pointed out that the concept of "proportionate" is termed differently by local insurance regulation and expressed concerns that an overly strict definition in IFRS 17 would create conflicts.

<u>Restriction to proportionate</u>

44. Some stakeholders further questioned the rationale for restricting the proposals to proportionate reinsurance. These stakeholders contend that the proposed amendment should be applicable to all reinsurance contracts held where a direct link can be established between the reinsurance arrangements and the underlying insurance contracts. These stakeholders assert that it is feasible to determine a recovery percentage which can be used to estimate the recovery corresponding to the underlying loss, and that this can be equivalently done for proportionate and non-proportionate (e.g. facultative excess of loss) reinsurance.

45. Some stakeholders pointed to the current guidance in IFRS 17.66(c)(ii) which requires that when an underlying group of insurance contracts becomes onerous after initial recognition because of adverse changes in estimates of fulfilment cash flows, a loss is recognised with respect to that underlying group and the corresponding changes in cash inflows from reinsurance contracts held should be recognised in profit or loss. These stakeholders argued that given the guidance for contracts that subsequently become onerous is not restricted to proportional reinsurance, it is not clear why the proposals related to initial recognition are restricted as long as a direct linkage can be established (which they argue can be).

<u>Timing of recognition of reinsurance contract</u>

46. Some stakeholders questioned the Board's rationale for restricting the proposed amendment such that reinsurance contracts held must be recognised before or at the same time that the related onerous contract loss is recognised. These stakeholders asserted that it is common for entities to enter into reinsurance arrangements at dates subsequent to when the related underlying insurance contracts were entered into, and that retroactive reinsurance arrangements can sometimes be seen in practice. These stakeholders also maintain that they may enter effective verbal agreements or agreements established by mutually-understood practice before or at the same time that the related insurance contracts are entered into, and questioned the timing of contract enforceability versus the proposed requirements. These stakeholders would prefer to see the guidance relaxed so that the proposals could be applied in such scenarios.

<u>Other interpretation issues</u>

47. One stakeholder questioned the treatment of the loss-recovery component of the asset for remaining coverage. This stakeholder considered the guidance in ED.IE Example 19 to be unclear as to whether the loss-recovery component and CSM should be tracked separately, and that there was a lack of guidance for whether systematic allocation or a coverage unit concept should be applied to the roll-forward of the loss-recovery component.

HKICPA analysis and recommendation

48. The HKICPA is supportive of this proposal overall, and appreciates the Board's efforts to address the treatment of reinsurance contracts held when the underlying insurance contracts are onerous on initial recognition, as the HKICPA recommended IASB staff to consider as a proposed amendment to IFRS 17.

<u>Definition of reinsurance contract held that provides proportionate coverage</u>

49. We share the concerns of our stakeholders that the definition and scope of "proportionate coverage" currently results in many forms of proportionate reinsurance, including types of quota share and surplus share, not meeting the definition. The current proposal appears to be written in a manner that envisions a simplified textbook scenario. This would hamper the usefulness of the proposals and fail to faithfully represent the diversity of proportionate reinsurance arrangements, while also creating comparability issues.

50. We hence recommend that the Board reconsider the definition and scope of qualifying reinsurance in view of the various forms of arrangements present in the market, and draft a principle-based definition that will capture reinsurance contracts that provide an entity a right to recover a known percentage or currency unit amount of claims for a loss that corresponds to underlying insurance contracts.

51. We recommend that the Board consider whether the concept of a recovery percentage can be applied to demonstrate that underlying losses have knowable recoveries. The recovery percentage can be calculated by dividing expected recoveries by expected underlying claims, and this can be applied for various forms of reinsurance.

52. We also suggest that the drafting clarify that the definition may be assessed on either a group or individual contract level. The purpose of this would be to address concerns noted above for groups where reinsurance arrangements are applied on a known basis to individual contracts, but would vary at the group level given the known basis could vary contract-by-contract. Additionally, this would take into account situations where not all contracts within a group are covered by a single reinsurance treaty and instances of proportionate facultative reinsurance transacted on an individual risk basis.

53. Assuming that the Board elects to retain the proposal's restriction to proportionate reinsurance (discussed further below), we suggest the following potential edits to address our concerns above:

- Appendix A, definition of *reinsurance contract held that provides proportionate coverage*. Alternative drafting could read:
    - *A reinsurance contract held that provides an entity with the right to recover from the issuer a <u>contractually defined</u> percentage of all claims incurred on groups of underlying insurance contracts <u>or individual underlying insurance contracts within a group of contracts</u>. ~~The percentage the entity has a right to recover is fixed for all contracts in a single group of underlying insurance contracts, but can vary between groups of underlying insurance contracts.~~*
- B119C.
    - *Paragraph 66A applies to reinsurance contracts held that provide proportionate coverage. Such reinsurance contracts provide the entity with the right to recover from the issuer a <u>contractually defined</u> ~~fixed~~ percentage of all claims incurred on a group of underlying insurance contracts <u>or individual underlying insurance contracts within a group of contracts</u>. …*
- B119D.
    - *An entity shall determine the adjustment to the contractual service margin and the resulting income recognised applying paragraph 66A by multiplying:*
      (a) the loss recognised on the group of, or individual, underlying insurance contracts within a group of contracts ; and
      (b) the <u>contractually defined</u> ~~fixed~~ percentage of claims on the group of underlying insurance contracts<u>, or individual underlying insurance</u>

contracts within a group of contracts, the entity has a right to recover from the group of reinsurance contracts held.

Restriction to proportionate

54. The HKICPA considers that the most critical issue regarding this proposal is to expand the scope of proportionate reinsurance arrangements eligible for inclusion as discussed above. However, we also agree with our stakeholders who argue that recovery amounts can be known for non-proportionate (e.g. facultative excess of loss) reinsurance, and think that in principle the requirements should allow for such forms of reinsurance to fall within the scope of the proposals so long as the preparer can establish the appropriate recovery percentage. This would support consistent accounting for comparable economic phenomena.

55. To illustrate how the recovery can be known for both proportionate and non-proportionate reinsurance, and how the two types can result in equivalent economic phenomena, consider the following:

	Proportionate quota share *50% ceded to reinsurer*	**Non-proportionate excess of loss** *Loss above CU75 ceded to reinsurer*
Premiums	100	100
Claims	-150	-150
Expected loss	-50	-50
Expected recoveries	75	75
Recovery percentage	50%	50%
Recovery amount	25	25

56. Under the current proposal, these two arrangements would be accounted for differently because the excess of loss arrangement would not meet the definition of proportionate reinsurance. While the example above is highly simplified and the calculation would be more complex in practice, particularly for non-proportionate treaty reinsurance, we consider that the principle stands.

57. Should the Board elect not to allow non-proportionate reinsurance, we recommend that the Basis for Conclusions be expanded upon to explain why. We note that ED.BC80 attempts this, however we do not think it is adequately defended and the conclusion presented for the paragraph's example excess of loss contract is tenuous.

Timing of recognition of reinsurance contract

58. With regard to the restriction that reinsurance contracts held must be recognised before or at the same time that the related loss is recognised, the HKICPA appreciates our stakeholders' concerns but agrees with the Board's rationale presented in ED.BC85 that such a condition is relevant to ensure that the recovery of losses are recognised in alignment with the losses themselves.

59. On stakeholder comments about enforceability, we note that the concept of the enforceability of a contract is not unique to nor begotten by IFRS 17, and do not recommend to add further guidance in this area.

60. We consider that further relaxation of the guidance could introduce concerns with respect to the usage of the guidance to achieve a particular accounting outcome, and hence do not recommend broadening the proposals to include reinsurance contracts recognised after the related loss is recognised.

Question 7—Effective date of IFRS 17 and the IFRS 9 temporary exemption in IFRS 4 (paragraphs C1, [Draft] Amendments to IFRS 4 and BC110–BC118)

Stakeholders' views

61. Our stakeholders are supportive of the proposed amendment to defer the effective date by one year, and feedback indicates that this amendment will be beneficial to the majority of preparers. Some stakeholders noted that this is particularly welcome for Hong Kong and other non-European markets that have not been through full implementation of Solvency II and hence are at a different starting point with respect to systems and data.

62. Several stakeholders emphasized the importance of a globally consistent effective date among major jurisdictions, and our user stakeholders also expressed a preference for having globally comparable financial reporting. Given the significant impact that IFRS 17 adoption is expected to have, a misaligned adoption date could result in tangible economic deviations arising between entities in different jurisdictions. It would also create substantial negative comparability issues that would exist for many years going forward. A level playing field for entities is considered of high importance, and that will only be achieved through a consistent effective date.

63. Several stakeholders noted that although they supported the deferral of the effective date by one year, two years would have been preferred. This is because there is a dearth of service providers and comprehensive IT solutions in the market and this presents significant implementation challenges, which are especially pronounced for smaller insurers. These stakeholders further noted that the proposals in the ED have exacerbated this as both preparers and service providers have had to respond to a moving target.

HKICPA analysis and recommendation

64. The HKICPA welcomes the proposed amendment to defer the effective date by one year and considers it a helpful action that will support implementation.

65. We further agree with our stakeholders' comments concerning the importance of a uniform effective date across major jurisdictions. We recommend that the Board takes into consideration that IFRS 17 represents a significant change to financial reporting that may have a material impact on how entities are perceived by users, and as with other major Standards aim to encourage a consistent timeline for global adoption.

Question 9—Minor amendments (BC147–BC163)

Stakeholders' views

66. Our stakeholders noted that there is an unsolicited edit in ED.B107(b)(i), which now reads "*over the duration of the ~~group of~~ insurance contract ~~contracts~~;*". This could be interpreted to require that to qualify for the variable fee approach, an entity must assess variability on an individual contract level rather than the group level.

67. These stakeholders commented that such a change not only lacks any rationale, but would also heavily disrupt implementation for entities with IFRS 17 projects already in progress, and introduce significant operational costs and complexities given the size and scope of certain portfolios.

HKICPA analysis and recommendation

68. The HKICPA notes that the edit to ED.B107(b)(i) does not appear to have been solicited prior to publication of the proposals, and the questions in the ED do not seek feedback on the change.

69. The November 2016 IASB meeting Agenda Paper 2C states the following as an issue related to the level of aggregation that the staff proposed the Board not further address, which implies that the group is the appropriate level for assessing the variable fee approach and aligns with the existing drafting in IFRS 17.B107:

Scope of variable fee approach Some test participants asked for clarification on the level of aggregation for assessing eligibility for the variable fee approach.	Because the contracts are measured as part of a group, the group is the unit of account. The scope of the variable fee approach and in particular the assessment of expected cash flows is assessed on the basis of the cash flows of the group.

70. The impact of this edit is significant to our stakeholders, and it concerns us that such an edit is put forth in an unsolicited manner. The HKICPA strongly recommends the Board reverts paragraph B107 to its prior wording, and clarifies the intention of the proposed edit. If the Board wishes to propose edits or changes to B107, they should be subject to proper IFRS Foundation due process.

Other areas of comment

71. The HKICPA is generally supportive of the proposals in ED questions 1, 5, 6, 8 and 10, and we noted limited comments and no significant disagreements from our stakeholders on these issues. We include comments from our stakeholders for the Board's consideration.

Question 1—Scope exclusions—credit card contracts and loan contracts that meet the definition of an insurance contract (paragraphs 7(h), 8A, Appendix D and BC9–BC30)

Stakeholders' views

72. This proposal was not relevant for many of our stakeholders. Those who commented were generally supportive.

Question 5—Presentation in the statement of financial position (paragraphs 78–79, 99, 132 and BC91–BC100)

Stakeholders' views

73. Our stakeholders are generally supportive of this proposal. Some stakeholders commented that this proposal would better reflect the way their business is managed, and that it would provide operational relief.

Question 6—Applicability of the risk mitigation option (paragraphs B116 and BC101–BC109)

Stakeholders' views

74. Our stakeholders are generally supportive of this proposal. A couple of stakeholders commented that it would result in a more faithful representation of the economics.

75. One stakeholder requested that it be clarified whether the proposals will also apply to investment contracts with discretionary participation features that are accounted for under IFRS 17.

Question 8—Transition modifications and reliefs (paragraphs C3(b), C5A, C9A, C22A and BC119–BC146)

Stakeholders' views

76. Our stakeholders are generally supportive of this proposal. One stakeholder requested that further clarification be provided as to the Board's rationale for the option to apply the fair value approach and when the option may be used. This stakeholder commented that although the proposed relief is welcomed, their preferred approach would still be to allow existing risk mitigation tools to be reflected in a fully retrospective manner.

Question 10—Terminology

Stakeholders' views

77. Our stakeholders are generally supportive of this proposal.