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

Meeting Summary
Hong Kong Insurance Implementation Support Group (HKIISG)
26 April 2019

Attendance
HKICPA representatives
Sanel Tomlinson, Immediate Past Member, Financial Reporting Standards Committee (FRSC)
Christina Ng, Director, Standard Setting
Michelle Fisher, Deputy Director, Standard Setting
Kam Leung, Associate Director, Standard Setting

HKIISG members
Douglas Mason (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
Steven To (representing Kenneth Dai), Manulife Asia
Candy Ding, Ping An Insurance (Group)
Carrie Yip (representing Nigel Knowles), Prudential Hong Kong Limited
Joyce Lau, Target Insurance Company, Limited
Francesco Nagari, Deloitte Hong Kong
Doru Pantea, EY Hong Kong
James Anderson (representing Erik Bleekrode), KPMG China
Ian Farrar (representing Chris Hancorn), PwC Hong Kong

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.

Debrief: IASB TRG meeting, April 2019 (Debrief Summary)
The below summary should be read in conjunction with the IASB April 2019 TRG meeting summary.

TRG members in the HKIISG (Mr. Francesco Nagari and Ms. Sally Wang) gave a summary of the meeting and the following points were raised by HKIISG members on the papers.

TRG April 2019 Paper AP01: Investment components within an insurance contract
No major comments were raised by HKIISG members. A few HKIISG members did not fully agree with the following points in the IASB TRG paper:

- The definition of an investment component as the amount that the contract requires the entity to repay a policyholder in all circumstances, regardless of whether the insured event occurs
- An investment component could exist even if the amount of payment is zero
- Payments could represent a refund of premiums for unused coverage rather than an investment component in some cases

TRG April 2019 Paper AP02: Reporting on other questions submitted
On submission S115, a few HKIISG members raised the following concerns:
- Whether the mortality charge is treated as a percentage of asset share or underlying item could become a case of form over substance.
- There is an opportunity for structuring. For example, insurers can construct any spread or any management fee so that it is not related to the underlying items, which means that it would not pass through the assessment of 'substantial' in IFRS 17.B101(b).
- IFRS 17 paragraphs B101(b) and (c) are very important for Asia, and it might be worth exploring what more can be done on the issue in the future.

Action/Conclusion:
No immediate action.

Local submission: Contract Boundary when applying the Fair Value Approach on transition (Paper 3)
Paper 3 discusses the fair value approach on transition to IFRS 17.

The paper observes that IFRS 17.C20 states that IFRS 13 is applied in determining the fair value, but that IFRS 13.47 (demand deposit guidance) is ignored. This indicates that IFRS 17 requires a ‘real’ fair value based on a market participant’s perspective to be used in measurement, i.e. not one that limits the fair value to the amount repayable on demand and/or ignores 'contract renewal' behaviour.

However, the paper also observes that if the contract boundary for IFRS 13's fair value measurement (FVM) is applied on transition, then renewals that are outside of the IFRS 17 contract boundary will be included in the fair value at transition, and a CSM on those renewals would be recognised at the transition date. However, when in a later period the renewals are recognised as new contracts in accordance with IFRS 17, it would lead to recognition of that element of the CSM again - that would seem to result in double counting.

The paper then asks if the contract boundary for IFRS 13 fair value measurement (FVM) should be the same as the contract boundary for IFRS 17 fulfilment cash flows (FCF). Three views were presented in the paper, which are:
1) Yes: the contract boundary under IFRS 13 is the same as IFRS 17
2) No: the contract boundary should follow IFRS 13 requirements
3) IFRS 17 should be amended to eliminate the unintuitive result arising from applying IFRS 13's contract boundary on transition.

Mixed views on whether view 1 or view 2 is appropriate
There were mixed views as to whether view 1 or view 2 is appropriate.
- Proponents of view 2 note that IFRS 17 points to IFRS 13 when applying the fair value approach upon transition, and that IFRS 13 requires the market participants' perspective to be taken into account when determining the cash flows.
- Proponents of view 1 note that incorporating the perspective of market participants is not supportable in IFRS 17 literature and creates a 'new' contract boundary which produces counter-intuitive accounting outcomes.

Some members thought that the Standard is unclear whether View 1 or View 2 is appropriate.

Nevertheless, many members expressed support for view 1 (the contract boundary under IFRS 13 is the same as IFRS 17), because:
- The contract boundary definition in IFRS 17, despite being a measurement characteristic, is fundamental to measuring an insurance contract and should take precedence over IFRS 13's market participant perspective; and
- Applying the contract boundary from an IFRS 13 perspective would produce

counter-intuitive accounting outcomes; introduce additional considerations for market participants; and make the accounting less consistent and comparable with IFRS 17.

Despite the support for view 1, some members also commented that view 1 is not fully substantiated by accounting literature and they were not fully comfortable with it. In response, one member argued that the accounting literature can be interpreted as follows:

- IFRS 13 requires the assets and liabilities to be measured at fair value.
- When defining the asset/liability, in this case an insurance contract, one shall refer to IFRS 17 which provides the definitional characteristics of what an insurance contract is (including the contract boundary, because it gives you the population of cash flows to be accounted for).
- With the cash flows that make up an insurance contract defined, then they and the associated contract can be measured by applying IFRS 13's fair value measurement.

A few members responded that the definition of an insurance contract in IFRS 17 Appendix A does not include the contract boundary. As such, view 2 could arguably be better substantiated by the accounting literature. Two members questioned if the discount rate as defined in IFRS 17 can then be extended to be used when applying IFRS 13's fair value measurement, by analogy to the above interpretation.

Other comments
One member commented that when the contract renews, all measurements are 'restored' to IFRS 17 and hence there should be no double counting. Rather, it is a timing difference of when profits are recognised which may result in an unfavourable volatility or a shifting of profit pattern. As such, it will be important to assess the impact of transition to IFRS 17 on equity.

In addition, this member noted that in the example provided, it is possible, and better to use the full retrospective approach on transition, rather than the fair value approach.

<u>Action/Conclusion:</u>
No immediate action.

Local submission: Premium-based profits tax when measuring fulfillment cash flows (Paper 4)
In Hong Kong, some income arising from long-term insurance businesses are assessable under Hong Kong profits tax law and deemed to be 5% of the premiums. This paper discusses whether profits tax assessed on this deemed income basis should be included in the estimation of fulfilment cash flows under IFRS 17 or accounted for as income tax under IAS 12.

IAS 12 Income Tax
Members generally commented that the premium-based profits tax should be assessed under IAS 12 as a starting point and as is currently done in Hong Kong.

If it is in the scope of IAS 12, a few members questioned how to align the recognition of premium-based deemed taxable income with the recognition of profit under IFRS 17. One member argued that if premium-based profits tax is considered to be in the scope of IAS 12, then deferred tax should also be recognised. However, a few other members noted that it is not clear what the tax base is and whether it is possible to recognise deferred tax under IAS 12.

Comments on the alternative views set out in the paper:
Other comments made by members included:

- If it is not in the scope of IAS 12, the income tax expense financial statement line item would disappear, which may not be useful for users of financial statements.
- There is a struggle to see how the profit taxes assessed on a deemed taxable income that is based on premium amounts are paid in a “fiduciary” capacity under IFRS 17

paragraph B65(j).
- It is difficult to see how, in substance, this premium-based profits tax is not income tax under the scope of IAS 12.
- If the premium-based profits tax is assessed to be outside the scope of IAS 12, then it may be considered an acquisition cost to be spread over the expected coverage period.

Other considerations relating to IFRS 17 paragraph B65(m)
A few members noted that the scope and application of IFRS 17 paragraph B65(m) is quite narrow. One member emphasised that the term 'specifically chargeable' in paragraph B65(m) would mean that the chargeable item would need to be stated explicitly in the policyholder's contract. However, this does not appear to be the case for premium-based profits tax in Hong Kong. Another member questioned if customary business practices and/or approval by the company's Board on the nature of this premium-based profits tax would be sufficient support to be in paragraph B65(m).

Separately, one member further questioned whether participating contracts can be considered under the scope of paragraph B65(m).

Other questions
One member questioned what the Hong Kong Inland Revenue Department is considering doing about income tax once IFRS 17 is effective. HKICPA staff commented that the IRD has been made aware of the major differences between HKFRS 4 and HKFRS 17 but the IRD plans to consider the income tax implications arising from the standard at a later stage. HKICPA staff will continue to urge IRD to provide clarity on its views soon.

Action/Conclusion:
Members agreed that a separate paper analyzing this issue from the perspective of IAS 12, including an analysis of whether recognition of deferred tax is possible, should be prepared and discussed at the HKICPA's Insurance Regulatory Advisory Panel. Mr. James Anderson (HKICPA IRAP member and meeting delegate for HKIISG member Erik Bleekrode) volunteered to prepare the paper for IRAP's discussion.

Local submission: Proposed approach for determining coverage units for groups of contracts with multiple services (Paper 5)
This paper is connected with the meeting paper 3 discussed at the January 2019 HKIISG meeting. Refer to the related meeting summary for details.

Members continued to express similar concerns as outlined in the January 2019 HKIISG discussion.

In addition, members noted that because determining coverage units for groups of contracts with multiple services is a pervasive issue across industry—to date, there is no operational solution to determine blended coverage units—this issue should be brought to the IASB's attention.

One member commented that they had a prototype of an operational solution, but that it is not public. The prototype is based on the fulfillment cash flows and was previously outlined in a past HKIISG meeting (refer to meeting summary of January 2019 HKIISG discussion). This member noted that they had tested the proposed approach outlined in paper 5 for the specific circumstances it is applicable for, and it gave the same accounting outcome as the prototype based on FCF. However, this member observed that the approach in the paper is dependent on the facts and circumstances. Absent those facts and circumstances the result could be open to challenge. For example if the price charge for individual coverages included in the single contract is adjusted to achieve a degree of cross-subsidisation across the bundled coverages. The reliance of the technique on the portion of expected inflows that arise from the terms and conditions set by the insurer would produce a different CSM release pattern in this instance even if the underlying expected outflows were not different. This member observed that the technique in the paper could be even more widely applicable if it had utilized the expected outflow by individual bundled coverage rather than the expected inflows. The calculation of a contract-based CSM “profit margin” would have produced the same release of CSM to profit or loss even if the inflows were reallocated across the bundled coverages. The contract-based CSM “profit margin” applied to the expected outflows for each bundled coverage would not have responded to that change if the total CSM from the contract had remained the same.

Action/Conclusion:
Members suggested including this issue (with a broader fact pattern and recommended solutions) in the HKICPA’s comment letter on the upcoming IASB exposure draft on the proposed amendments to IFRS 17.

In addition, HKICPA staff commented that it would explore possible avenues of further discussion with the IASB.

Staff update and any other business
HKICPA staff updated members on the IFRS 17 Global Developments Forum on 4 July and roundtables on the proposed amendments to IFRS 17 on 4 and 5 July. It also updated members on the intensive HKFRS 17 training program, mainly focused on general insurers, taking place from June 2019 until December 2020.

HKICPA staff also noted that the HKICPA’s Financial Reporting Standards Committee (FRSC) had a discussion, in February 2019, as to whether to consider other alternatives for SME insurers. However, the FRSC noted that whilst it acknowledges the resourcing challenges for SME insurers, as many smaller general insurers have not substantially started implementing HKFRS 17, there is not sufficient evidence that the standard is difficult to implement. HKICPA staff commented that it would also continue to liaise with regulatory bodies.

HKICPA staff reported back on the recent meetings of the International Forum of Accounting Standard Setters and the IASB’s Accounting Standards Advisory Forum. It was noted that the proposed amendments to IFRS 17 were discussed at both meetings, and in general, the feedback was positive for the IASB to go ahead with all of the proposed amendments.

On the future of HKIISG, the HKICPA staff commented that in December 2018, the FRSC agreed that the HKIISG would continue operating past the IASB TRG as long as there are local submissions to be discussed. One member requested HKICPA staff to explore collaboration with other jurisdictional TRGs such as in Australia, as well as with the insurance working group of the Asian-Oceanian Standard Setters Group.

Action/Conclusion:
Members agreed that an additional meeting should be scheduled in July to discuss the IASB exposure draft of proposed amendments to IFRS 17. In addition, members agreed that the meetings scheduled for 29 May and 4 June should be combined.

Post-meeting note: The updated meeting schedule is available here.