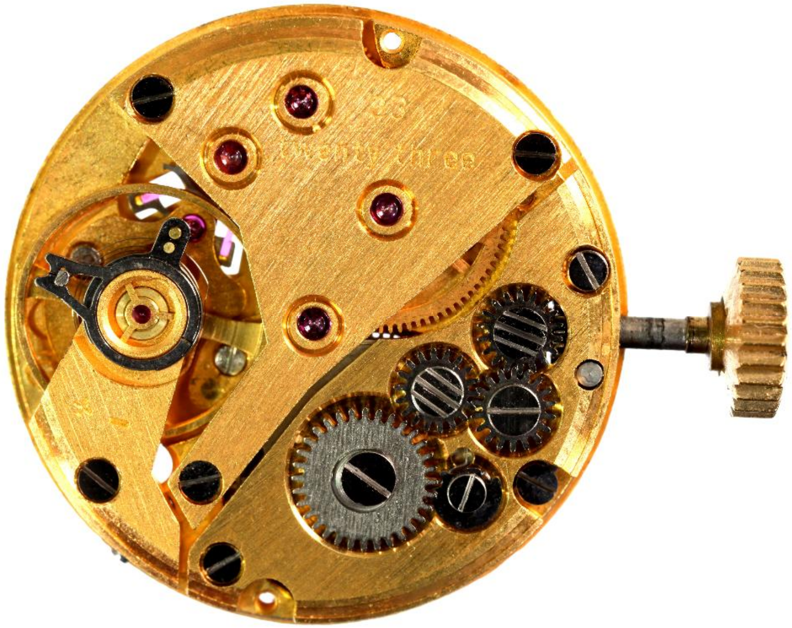

IFRS 17 TRG: 4 April 2019

HKIISG points for IASB TRG

Francesco Nagari, Deloitte Global IFRS Insurance Leader | 26 April 2019

Agenda

IFRS 17 TRG

1. **Updates from the TRG 4 April 2019**
2. **Debrief on:**
   - **Investment components within an insurance contract**
   - **Reporting on other questions submitted**
   - **Annual improvements**
3. **Next steps**

Updates from the TRG 4 April 2019

- The TRG for IFRS 17 Insurance Contracts met on 4 April 2019 to discuss about:
  - Investment components within an insurance contract; and
  - Reporting on other questions submitted

- These submissions have been categorised as questions that:
  (a) can be answered applying only the words in IFRS 17;
  (b) do not meet the submission criteria; or
  (c) are being considered through a process other than a TRG discussion (such as a proposed annual improvement)

- 43 out of 46 submissions were rejected as the IASB Staff considered that most of the questions can be answered with the current standard or do not meet the submission criteria.

- All the points from the HKIISG on Reporting on other questions submitted were covered. The IASB has committed to capture the TRG outcomes in a way that will be permanently accessible to preparers and users. The timing for this and the format it would take will be announced in due course.

Investment components within an insurance contract

Determining whether an insurance contract includes an investment component

- **The Staff observed that the definition of an investment component refers to a payment that is required 'even if an insured event does not occur'. The IASB:**
  - **(a) decided that an investment component should be defined as the amount that the contract requires the entity to repay to a policyholder in all circumstances, regardless of whether the insured event occurs; and**
  - **(b) rejected defining the investment component as 'the amount that the contract requires the entity to repay to a policyholder when an insured event does not occur'.**

Assessing whether an investment component is distinct

- **The Staff observed that an investment component with equivalent terms must reflect all the terms of the investment component within the contract. A financial instrument paying fixed amounts for a defined period of time starting from inception would be available on the market where the entity operates.**

- **It is unlikely though to have equivalent terms to an investment component within an insurance contract for which the timing of the payment depends on the death of the policyholder.**

Determining the amount of an investment component

- **The amounts that would be payable if no insurance event had occurred are determined on a present value basis, and the Staff considered that it would therefore be consistent with paragraph B21 of IFRS 17 to determine the investment component on a present value basis too.**

Investment components within an insurance contract

Examples of insurance contracts provided by the submissions and other fact patterns provided to the Staff

Example – Immediate annuity contract with a guarantee payment period	Does the contract include an investment component?	Is the investment component distinct?	What is the amount of the investment component?
• The submissions state that, in exchange for premiums, the immediate annuity contract with a guarantee payment period promises to make regular payments to: (a) the policyholder for the remainder of the policyholder's life; or (b) the estate of the policyholder for a remaining guaranteed period if the policyholder dies before the end of the guaranteed period.	• The Staff view is that the immediate annuity contract with a guarantee payment period includes an investment component. • The Staff observed that the contract requires the entity to make a payment in all circumstances—ie regular payments to the policyholder or to the estate of the policyholder for a guaranteed period.	• The Staff observed that the policyholder is not able to benefit from one component in the absence of the other component. As a result, the investment component within this contract is not distinct and the entity cannot separate it from the insurance contract.	• The Staff observed that the entity determines the amount of the non-distinct investment component when the entity makes regular payments for the guaranteed period either to the policyholder or to the estate of the policyholder.

Investment components within an insurance contract

Examples of insurance contracts provided by the submissions and other fact patterns provided to the Staff

Example – Deferred annuity contract	Does the contract include an investment component?	Is the investment component distinct?	What is the amount of the investment component?
The submission states that the deferred annuity contract promises: (a) if the policyholder dies or terminates the contract before reaching 60 years old, to pay a surrender amount to the policyholder; or (b) if the policyholder reaches 60 years old, to make regular payments to the policyholder for the remainder of the policyholder's life. In addition, if the policyholder dies before reaching 80 years old, the contract requires the entity to pay an amount at least equal to the amount accumulated by the policyholder through deposits less payments already made.	• The Staff view is that the contract includes an investment component. • The Staff observed that the deferred annuity contract requires the entity to make a payment in all circumstances, either: (a) a surrender amount, if the policyholder dies or terminates the contract before reaching 60 years old; or (b) an amount that is equal to the amount accumulated by the policyholder through deposits, if the policyholder reaches 60 years old.	• The Staff view is that the entity cannot measure the insurance component without considering the investment component. • As a result, the investment component within this contract is not distinct and the entity cannot separate it from the insurance contract.	(a) the policyholder dies or terminates the contract before reaching 60 years old. The entity pays a surrender amount. The Staff view is that the entity excludes that amount from insurance revenue and insurance service expenses when the surrender amount is paid. (b) the policyholder reaches 60 years old. The entity makes regular payments that could exceed the amount accumulated by the policyholder through deposits. The Staff view is that the entity excludes the amount accumulated through deposits from insurance revenue and insurance service expenses when regular payments are made up to the amount accumulated.

Investment components within an insurance contract

Determining whether an insurance contract includes an investment component

- In determining whether the contract requires the entity to make a payment in all circumstances, the Staff observed that:

  (a) paragraphs 10–13 of IFRS 17 require an entity to assess at inception whether an investment component is separated from an insurance contract.

  (b) different events can trigger a payment to a policyholder under an insurance contract.

  (c) paragraph B18 of IFRS 17 states that an entity needs to assess the insurance risk excluding scenarios that have no commercial substance (i.e. no discernible effect on the economics of the transaction).

  (d) in some scenarios, the amount of the payment could be zero. However, this does not necessarily mean that no investment component exists. For example, an entity would need to consider whether a scenario in which the amount of payment is zero arises from:

    (i) a payment that an entity makes to the policyholder early in the coverage period

    (ii) the policyholder's decision to use a payment due from the entity to settle amounts due to the entity.

  (e) a payment amount calibrated to reflect outstanding future periods in which a service is provided that may indicate that the policyholder is entitled to a premium refund reflecting its consumption of service over the life of the contract. In this case, the payments may represent a refund of premiums for unused coverage rather than an investment component.

Investment components within an insurance contract

Determining whether an insurance contract includes an investment component

Assessing whether an investment component is distinct

Aspects to consider when determining whether cash flows are not highly interrelated

- **Condition 1: the cash flows of the insurance component are not highly interrelated with the cash flows from the investment component.**
- **Condition 1A: an entity cannot measure one component without considering the other component when the value of one component varies according to the value of the other component.**
- **Condition 1B: the policyholder cannot benefit from one component even though the other component is not present when the lapse or maturity of one component causes the lapse or maturity of the other component. The Staff observed that:**

  (a) the benefit provided by an insurance contract is the service provided by the contract, and not the settlement of amounts due to the policyholder. Thus:

  (i) the policyholder can benefit from an investment component even when the contract has fulfilled the insurance coverage and the entity only has to settle claims; and

  (ii) the policyholder can benefit from an investment component when the contract provides an investment return service or an investment-related service.

  (b) the lapse or maturity of one component causing the lapse or maturity of the other component is sufficient to conclude that the two components are highly interrelated.

  (c) a contractual term preventing the policyholder from cancelling the investment component or the insurance component or both may indicate that the policyholder cannot benefit from one component without the other.

Investment components within an insurance contract

Determining whether an insurance contract includes an investment component

Assessing whether an investment component is distinct

Aspects to consider when determining whether cash flows are not highly interrelated

- **In January 2019 the Board tentatively decided to amend IFRS 17:**

  (a) so that in the general model the CSM is recognised in profit or loss on the basis of coverage units that are determined by considering both insurance coverage and investment return service, if any; and

  (b) to establish that an investment return service exists only when an insurance contract includes an investment component.

Investment components within an insurance contract

Determining whether an insurance contract includes an investment component

Changes in the carrying amount of the CSM for insurance contracts without direct participation features (paragraph 44)

- B96 for insurance contracts without direct participation features and paragraph 44(c) require an adjustment to the contractual service margin of a group of insurance contracts for changes in fulfilment cash flows that relate to future service. These changes comprise:

  (a) experience adjustments arising from premiums received in the period that relate to future service, and related cash flows such as insurance acquisition cash flows and premium-based taxes, measured at the discount rates specified in paragraph B72(c);

  (b) changes in estimates of the present value of the future cash flows in the liability for remaining coverage, except those described in paragraph B97(a), measured at the discount rates specified in paragraph B72(c);

  (c) differences between any investment component expected to become payable in the period and the actual investment component that becomes payable in the period, except those described in B97(a) measured at the discount rates specified in paragraph B72(c); and

  (d) changes in the risk adjustment for non-financial risk that relate to future service.

Reporting on other questions submitted

Key rejections under criteria (a) – Can be answered applying only the words in IFRS 17

Log#	Topic	Question	Response
S115	Definition of insurance contracts with direct participation features- applying paragraph B101(b) of IFRS 17	Should the share of the fair value returns be calculated net of charges paid to receive the mortality cover?	A determination based on any calculation other than a calculation of the policyholder's share in the gross fair value returns on the underlying items would be inconsistent with the requirements of IFRS 17. Paragraph B101(c) of IFRS 17 requires that the entity expects a substantial proportion of any change in the amounts to be paid to the policyholder to vary with the change in fair value of the underlying items. For the purposes of this condition an entity considers changes in any amounts to be paid to the policyholder regardless of whether they have been paid from the underlying items or not. See Example on the next page where the fixed mortality charge is deducted from the underlying items with a consequential reduction of the fair value return. The policyholder share is then computed after deduction of investment management charges.

Reporting on other questions submitted

Example — Application of paragraph B101(b) of IFRS 17 (S115)

(a) Without mortality charge

An insurance contract gives the policyholder the returns on underlying items, after paying an annual management fee of 0.75% of the assets. The expected duration of the contract is 10 years and the expected returns on underlying items are 5%.

Year	1	2	3	4	5	6	7	8	9	10	TOTAL
Opening balance	15,000	15,632	16,290	16,977	17,692	18,437	19,214	20,023	20,867	21,746	
Returns on underlying items	750	782	815	849	885	922	961	1,001	1,043	1,087	9,094
Annual Management fee	(118)	(123)	(128)	(134)	(139)	(145)	(151)	(158)	(164)	(171)	(1,432)
Closing Balance	15,632	16,290	16,977	17,692	18,437	19,214	20,023	20,867	21,746	22,662	

(b) With mortality charge

An insurance contract gives the policyholder the returns on underlying items, after paying an annual management fee of 0.75% of the fair value of the underlying items. The expected duration of the contract is 10 years and the expected returns on underlying items are 5%. An annual charge for mortality cover of 100 reduces the underlying items at the start of each year.

Year	1	2	3	4	5	6	7	8	9	10	TOTAL
Opening balance	15,000	15,527	16,076	16,648	17,245	17,866	18,514	19,189	19,892	20,625	
Mortality charge	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(1,000)
Returns on underlying items	745	771	799	827	857	888	921	954	990	1,026	8,779
Annual Management fee	(118)	(122)	(127)	(131)	(136)	(141)	(146)	(151)	(157)	(162)	(1,390)
Closing Balance	15,527	16,076	16,648	17,245	17,866	18,514	19,189	19,892	20,625	21,389	

Reporting on other questions submitted

Key rejections under criteria (a) – Can be answered applying only the words in IFRS 17

Log#	Topic	Question	Response
S118	Consideration of reinsurance in the risk adjustment for non-financial risk	Should the effect of reinsurance be considered in calculating the risk adjustment for non-financial risk for contracts that have been reinsured?	The risk adjustment for non-financial risk of a reinsurance contract held could not be nil, unless: (a) the entity considers reinsurance when determining the compensation it requires for bearing non-financial risk related to underlying insurance contracts; and (b) the cost of acquiring the reinsurance is equal or less than the expected recoveries. See Example on the next page
S119	Risk of non-performance of the issuer of a reinsurance contract held	The submission questions whether these risks are identified as financial or non-financial risks and the impact this determination has on the measurement of reinsurance contracts held when determining the risk being transferred applying paragraph 64 of IFRS 17.	The risk adjustment for non-financial risk of a reinsurance contract held reflects only the risks that the cedant transfers to the reinsurer. Paragraph 67 of IFRS 17 requires that changes in the fulfilment cash flows related to the risk of non-performance do not adjust the CSM, therefore an entity recognises them in profit or loss. This treatment is consistent with the accounting treatment for financial risks.

Reporting on other questions submitted

Example — Risk adjustment for non-financial risk when an entity expects to buy reinsurance (S118)

Suppose an entity would determine the premium it charges for insurance contracts as illustrated in the following table, ignoring the possibility of reinsurance and before considering any profit:

Present value of claims	100
Risk adjustment for non-financial risk	30
Premium	130

However, the entity knows that reinsurance is available to it, and the entity expects to cover 50% of claims using reinsurance. It expects the cost of purchasing this reinsurance to be 60.

	Expected to be covered by reinsurance	Not expected to be covered by reinsurance	Total insurance contracts issued
Present value of claims	50	50	100
Risk Adjustment for non-financial risk	10	15	25
Premium	60	65	125

The reinsurance contract held transfers 50% of the risk from the entity so is accounted for as follows:

Present value of claim recoveries	50
Risk adjustment for non-financial risk (=25/2)	12.5
CSM (net gain)	(2.5)
Reinsurance premium	60

Reporting on other questions submitted

Key rejections under criteria (a) – Possible contradictions on Premium Waiver

Log #	Topic	Question	TRG Meeting	Response
S117	Premium waiver presentation in profit or loss	Should an entity exclude from revenue premiums waived as a result of an insured event or account for them as part of insurance service expense (as an incurred claim)?	Apr 2019	Discussed at the April 2019 TRG meeting. Insured events give rise to claims. To the extent that a premium waiver results from an insured event, it is a claim. IFRS 17 requires an entity to recognise insurance service expenses for claims incurred in the period regardless of whether claims were settled net of premiums due. Treating premium waivers as claims is therefore consistent with the requirements of IFRS 17.

- TRG paper on investment component seems to contradict September 2018 TRG discussions.

Reporting on other questions submitted

Key rejections under criteria (c) - Questions that are being considered through a process other than a TRG discussion

Log#	Topic	Question	Response
S101, S120 & S124	Changes in the risk adjustment for non-financial risk due to time value of money and financial risk	S101: Should the portion of a change in the risk adjustment for non-financial risk due to the impacts of the time value of money and financial risk be excluded from the change in the risk adjustment for non-financial risk that relates to future service which adjusts the CSM? Assuming the answer to this question is yes, S101, S120 and S124 question the discount rate (locked-in rate or current rate) that would be used to adjust the CSM. The submissions also consider the interaction with paragraph 81 of IFRS 17.	The Staff will clarify as an annual improvement in the forthcoming Exposure Draft that the choice made in applying paragraph 81 of IFRS 17 would result in different adjustments made to the CSM under paragraph B96 of IFRS 17. If an entity applies the choice in paragraph 81 of IFRS 17, the adjustment to the CSM will be consistent with adjusting the CSM for changes in estimates of present value of future cash flows applying paragraph B96(b) of IFRS 17.

Annual improvements

Amendment to paragraph B96(c) of IFRS 17 to exclude changes relating to the time value of money and financial risk from the adjustment to the CSM.

Staff Analysis	• Paragraph B96(c) of IFRS 17 sets out requirements for the treatment of changes in an investment component in the general model. It does not require changes relating to the time value of money and financial risk to be recognised in profit or loss (or OCI), even though doing so is a clear principle of the general model. • The recommended amendment corrects that inadvertent omission. Now the experience variance shall be split in a portion that goes to P&L/OCI and one that goes to CSM. The latter is effectively the experience variance at the locked-in rate applicable to the general measurement model. This split would not be required in the VFA because non-financial and financial variables always adjust the CSM.

Annual improvements

Amendment to address disaggregation of changes in the risk adjustment for non-financial risk.

Apr 2019 TRG Feedback	• IFRS 17 allows, but does not require, an entity to disaggregate changes in the risk adjustment for non-financial risk into those caused by the time value of money and financial risk and those caused by changes in non-financial risk. • One TRG member observed that he thinks the option over the disaggregation of changes in the risk adjustment for non-financial risk relates only to presentation. He thinks that IFRS 17 prohibits disaggregation for measurement purposes. • Hence, he thinks paragraph B96(d) of IFRS 17 should not be amended to treat changes caused by the time value of money and financial risk differently from other changes, even if they are disaggregated for presentation purposes. He thinks a presentation choice should not change the measurement of insurance contracts. • The Staff recommendation simply and explicitly extends those requirements to such changes that have been disaggregated from the risk adjustment for non-financial risk. The Staff regard this as filling a gap in the Standard rather than changing the Standard.
Staff Analysis	• Paragraph B96(d) of IFRS 17 does not address the treatment of changes caused by the time value of money and financial risk if they are disaggregated. • The recommended amendment corrects that inadvertent omission.

Annual improvements

Amendment to clarify the definition of an investment component.

Apr 2019 TRG Feedback	• The feedback from the TRG reinforces the Staff view that it is important to clarify when an investment component exists, so there is more consistent understanding of the term. • The feedback from the TRG indicates that there is confusion and the possibility of diversity in practice over the existence of investment components. • For the purpose of measuring revenue and expenses, a separate analysis of the amounts of an investment component and refund of premium is not needed. • The Staff will consider whether a consequential amendment should be proposed to the requirement for a separate disclosure of the investment component.
Staff Analysis	• If the policyholder surrenders the contract, a refund of premium a payment may be made. No insured event occurred. However, if the coverage is fully consumed, the policyholder not entitled to any refund. It was not the Board's intention that such a contract should be regarded as including an investment component. • The recommended amendment clarifies the definition to achieve the Board's intention.

Annual improvements

Amendment to clarify that changes in the measurement of a group of insurance contracts caused by changes in underlying items should, for the purposes of IFRS 17, be treated as changes in investments and hence as changes related to the time value of money or assumptions that relate to financial risk.

Apr 2019 TRG Feedback	• The recommended amendment clarifies the definition of insurance finance income or expenses (IFIE) to achieve the Board's intention. • TRG members generally agreed that such changes in the measurement of the insurance contracts without direct participation features should not adjust the CSM, i.e. such changes should be treated in the same way as IFIE. However, they did not agree with the presentation of such changes as IFIE. • One TRG member also questioned whether there could be unintended consequences of treating the changes in the participating contracts as IFIE. • The Staff reiterated that the effect of changes in underlying items on the measurement of insurance contracts should be regarded as financial effects arising from the policyholders' participation.
Staff Analysis	• Changes in value of the underlying items affect the measurement of: (a) insurance contracts with direct participation features (b) insurance contracts without direct participation features • The recommended amendment clarifies the definition of IFIE to achieve the Board's intention.

Next steps

- **The Staff will now begin drafting the Exposure Draft, which it expects to issue by the end of June 2019. The comment period will be discussed at the 13-17 May 2019 IASB meeting. The Due Process Oversights Committee approved a reduced comment period of 90 days.**
- **The IASB has indicated that they would not plan another TRG meeting. They also made clear that the potential fifth meeting will depend on a continuous receipt of submissions from all IFRS 17 interested parties.**
- **The IASB Technical Plan states that the ED amending IFRS 17 will be published in June 2019.**

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