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

Meeting Summary
Hong Kong Insurance Implementation Support Group (HKIISG)
11 December 2019

Attendance
HKICPA representatives
Shelley So, Immediate Past Chair, Financial Reporting Standards Committee (FRSC)
Christina Ng, Director, Standard Setting
Michelle Fisher, Deputy Director, Standard Setting
Tiernan Ketchum, Associate Director, Standard Setting

HKIISG members
Sai-Cheong Foong*, AIA Group Limited
Norman Yao, AXA China Region Insurance Company Limited
Ronnie Ng, China Overseas Insurance Limited
Sally Wang, Dajia Insurance Group (via phone)
Kevin Wong, FWD Life Insurance Company (Bermuda) Limited
Alexander Wong, HSBC Life
Steven To (representing Kenneth Dai), Manulife Asia
Wenhao Zhao (representing Candy Ding), Ping An Insurance (Group)
Matsuta Ng (representing Nigel Knowles), Prudential Hong Kong Limited
Doru Pantea, EY Hong Kong
Francesco Nagari, Deloitte Hong Kong
Erik Bleekrode, KPMG China
Chris Hancorn, PwC Hong Kong

*****Attended item 3 only. For items 1 and 2, he was represented by Dennis Chiu, AIA Group Limited.

Apologies
Joyce Lau, Target Insurance Company Limited

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/IFRS 17.

The objective of this meeting was to discuss the IASB's preliminary response to comments on the Exposure Draft *Amendments to IFRS 17*, including in particular the IASB's consideration of other topics not specifically questioned on in the Exposure Draft (Item 2). The purpose of this discussion was to assess whether there are any further views or concerns to help inform the HKICPA in its ongoing discussions with the IASB.

1. Discussion on IASB's redeliberation plans for items raised in the HKICPA's comment letter

This summary should be read in conjunction with the IASB staff papers for the November and December 2019 IASB meetings on the IASB's *Amendments to IFRS 17* project.

The HKIISG noted and discussed the major areas of the Exposure Draft *Amendments to IFRS 17* on which the Institute focused its comments[1]. Members commented on the IASB's redeliberation plans and available information of staff proposals (as of the time of this HKIISG meeting, the December 2019 IASB meeting had not yet taken place).

Expected recovery of insurance acquisition cash flows

Members were generally supportive of the overall intention of this amendment to extend the recognition of an asset for acquisition cash flows to amounts allocated to expected renewals, and of requiring a recoverability assessment.

One member expressed concern that the IASB staff had not proposed to add guidance clarifying how to discount the expected net cash inflows. This member suggested that the absence of guidance on discounting may negatively affect comparability, and that this is particularly important in light of the required impairment test. This member commended that this creates complications for implementation, and that the proposed two-step impairment test exacerbates this complication. This member also emphasized that discounting guidance should make clear what the appropriate discount rates are (in terms of which rates on the term structure and in which time context the term structure should be determined). However, one member commented that it was preferable for the final Standard to be silent on the matter of discounting, given that it was preferable to have flexibility in this area for operational reasons.

A few members expressed concern with the proposals in the December 2019 IASB staff paper to confirm that the unit of account for an asset for insurance acquisition cash flows is the group of insurance contracts to which those cash flows have been allocated. These members stated that it will be operationally and judgmentally challenging to identify and forecast future groups that will include expected renewals. These members would prefer a higher level unit of account, such as the portfolio where the future groups will come from. One member questioned whether this unit of account would require slicing the asset into components by allocation to future groups and then testing each component for impairment separately. Another member commented that issues were discovered when trying to implement this requirement including needing to estimate how many groups of contracts there will be in the future, including how many onerous groups there will be. This member also questioned how this requirement would link back to the impairment test, and whether any impairment amount would need to be allocated back to each group of contracts. This member suggested that a preparer should not be expected to know what exact future group the amount of an asset for acquisition cash flows belongs given these future groups have yet to be recognized. Another member asserted that the requirement to use the group as a unit of account conflicts with the requirement to present any asset for insurance acquisition cash flows at a portfolio level.

One member commented that there is a lack of guidance on how to determine the asset balance on transition. This member stated that current transition guidance is not clear as to how asset amounts attributable to future groups should be treated, and that there should be a practical method for determining the asset balance at transition.

[1] https://www.hkicpa.org.hk/en/Standards-and-regulation/Standards/Our-views/pcd/financial-reporting-submissions/2019

A few members commented that the two-step impairment test (a group level impairment test and additional impairment test specific to insurance acquisition cash flows allocated to expected contract renewals) added undue complexity. One member suggested that the description proposed in the IASB staff paper is unclear as to whether the asset for acquisition cash flows is a two-part asset that needs to be tested for impairment in two clearly separate ways.

Contractual service margin (CSM) attributable to investment services – coverage units for insurance contracts without direct participation features

Members agreed to discuss this issue more specifically as part of Item 3 (Paper 3).

Reinsurance contracts held – recovery of losses

Members were generally supportive of the IASB staff's proposed direction on this amendment, in particular the broadening of the scope of the reinsurance contracts considered and the elimination of the "proportionate" restriction.

A few members however commented that the aim and intended application of the proposed new calculation of income was unclear. One of these members questioned whether the calculation would be applicable to all forms of reinsurance or if it could result in some reinsurance contracts (e.g. excess of loss reinsurance) not qualifying for the treatment under the amendment. Another member commented that further guidance would be needed to address complex situations (e.g. where underlying contracts have multiple risks and not all are ceded, or where the same risk is ceded to multiple reinsurers).

A couple members commented that it would be preferable that this amendment be finalized in a principle-based manner. One member suggested it would be preferable if the calculation were based on the "amount" of claims rather than the "percentage" of claims.

One member commented that it would be preferred if the amendment's requirements were optional on the basis that there may be cases where the financial effect will be minimal.

Minor amendments – edit to IFRS 17.B107

Members noted that the IASB November 2019 Agenda Paper 2B stated that some respondents expressed concern over what is described as an "*editorial correction to paragraph B107 of IFRS 17—for consistency with the wording of the requirements in paragraph B101 of IFRS 17, the Exposure Draft included an editorial correction to paragraph B107 of IFRS 17. Paragraph B101 of IFRS 17 requires an entity to assess contracts eligible for the variable fee approach at individual contract level. Paragraph B107 of IFRS 17, which is related to paragraph B101 of IFRS 17, incorrectly referred to a group of insurance contracts. Some respondents view the editorial correction to paragraph B107 of IFRS 17 as a major change to the requirements in IFRS 17 that would disrupt implementation.*"

One member commented that both that member and many practitioners had not interpreted IFRS 17 (including IFRS 17.B101) as requiring the assessment of contracts for the VFA eligibility on an individual contract level.

Several members commented that the proposed edit to IFRS 17.B107 in the Exposure Draft remains concerning because it is expected to considerably disrupt implementation and result in significant operational costs, both in terms of changing existing implementation and processes, and as an ongoing requirement to test new contracts on an individual basis.

A couple members commented that they considered that the requirement to assess variability at an individual contract level would not provide useful information to users.

Effective date of IFRS 17

A few members commented on the importance of a globally consistent effective date and suggested that the lack of such global consistency could create many issues. Some members also raised concerns that certain other bodies are considering deferral to 2023 or asking the IASB for such decision in their comment letters. One member noted that the Hong Kong Federation of Insurers (HKFI) has provided a letter to the HKICPA also commenting on importance of a consistent effective date. This member requested that the HKICPA consider these factors going forward.

One member stated that his organisation has not planned for any further delay. This member commented that while further delay could perhaps support a more orderly implementation, concerns that implementation cannot be achieved without such delay are unwarranted.

Another member expressed disagreement with further deferral on the basis that such deferral would result in additional ongoing costs (e.g. due to the need to run two systems).

The HKICPA staff noted the members' comments and commented that the request by certain bodies for a deferral of IFRS 17 to 2023 was not new information. The HKICPA staff also noted that there are respondents to the Exposure Draft that objected to delays, including the IASB's proposed effective date of 1 January 2022.

The HKICPA staff commented that the Institute has been closely monitoring the IASB's activity and the local situation in Hong Kong, including through meetings with the Insurance Authority. The HKICPA understands, as a result of these meetings, that the IFRS 17 readiness of insurers has improved. The HKICPA staff understand that the IASB will discuss the effective date at its February 2020 meeting.

The HKICPA staff commented that insurers in Hong Kong should continue their implementation efforts and not expect any specific delays or exceptions.

Next steps

The HKICPA staff will share members' key technical comments during subsequent discussions with IASB staff as the IASB redeliberates the amendments to IFRS 17.

The HKICPA staff will continue to monitor the situation in Hong Kong and globally with regard to the effective date of IFRS 17, which will include continued dialogue with the Insurance Authority. The HKICPA staff will be meeting with the Hong Kong Federation of Insurers to discuss their letter at a subsequent date.

2. Discussion on other topics that the IASB will consider further

This summary should be read in conjunction with the [IASB November 2019 Agenda Paper 2C] on the *Amendments to IFRS 17* project.

The HKIISG noted and discussed the comments received by the IASB on the five areas not specifically exposed for comment in Exposure Draft *Amendments to IFRS 17* that the IASB plans to consider further.

Level of aggregation – annual cohorts for some specific insurance contracts

One member noted his organisation had provided comments on mutualisation as part of its comment letter on the Exposure Draft and as a submission to the IFRS 17 Transition Resource Group. This member's preference is that the CSM should be adjusted at the level of a single combined risk sharing portfolio. Hence, the CSM would be adjusted proportionately to changes determined at the level of aggregation informed by IFRS 17.B67-71. This member was concerned that currently the IFRS 17 guidance does not address the accounting (unlocking) of the CSM, but rather only focuses on the fulfilment cash flows.

A couple of members commented that relief should be provided from the annual cohort requirement for contracts subject to mutualisation. These members considered that the separation by annual cohort does not reflect the way they manage their business.

A couple of members commented on the rate to be used for unlocking the CSM. One of these members noted that current guidance requires use of the locked-in rate. The other member questioned whether it would be beneficial for the unlocking to be based on current rates.

Another member commented that there was some confusion as to what discount rates (e.g. current or locked-in) should be used for the unlocking of mutualized contracts.

Business combinations – contracts acquired in their settlement period

One member suggested an approach focusing on presentation. This member suggested that no change should be made to the measurement of contracts acquired in their settlement period (i.e. measurement under the general model due to the acquisition as a liability for remaining coverage)), but that such contracts should be presented as liabilities for incurred claims, hence the unwinding of fulfilment cash flows and the CSM should be presented as an adjustment to insurance service expense rather than to insurance revenue (thus avoiding what is seen by some users the member consulted with as a misrepresentation of revenue).

Interim financial statements

One member commented that the IASB's consideration of the modification or deletion of IFRS 17.B137 was a welcome development. One member commented that at a minimum the requirement in IFRS 17.B137 should be waived on transition.

Additional specific transition modifications and reliefs

Members had no comments on this topic.

New concerns and implementation issues

One member noted respondents from jurisdictions other than Hong Kong (e.g. South Africa and the UK) had commented on the accounting treatment of policyholder taxes applying IFRS 17. This member commented that his organisation is still assessing the treatment of premiums-based profits tax and noted that this issue had been previously discussed by the HKIISG in April 2019 (Paper 4), as part of a local submission from this member's entity.

The HKICPA staff noted during the April 2019 HKIISG meeting, members agreed that a separate paper analyzing this issue from an IAS 12 perspective would be developed and brought to the HKICPA's Insurance Regulatory Advisory Panel. The HKICPA staff noted that this meeting had taken place, and that further due diligence steps are ongoing including meetings with the HKICPA Financial Reporting Standards Committee and HKICPA Income Tax Advisory Panel.

Next steps

The HKICPA staff will share members' key comments during subsequent discussions with IASB staff as the IASB redeliberates the amendments to IFRS 17.

3. Local submission: Examples of additional complexity due to the requirement to "weight" multiple services (Paper 3)

Paper 3 was presented to the HKIISG. This submission identifies practical difficulties in determining coverage units for insurance contracts without direct participation features as a result of the proposed amendments to IFRS 17 in relation to the CSM attributable to investment-return services. In particular, the paper explores the difficulties as a result of the proposed requirement to determine the relative weighting of the benefits provided by insurance coverage and investment-return service.

The paper analyses the proposed amendments in light of two typical products, explains the root causes of the complexity and discusses the pervasiveness of complex bundled products in Asia. It additionally explores two possible solutions designed to address the conceptual and operational challenges identified, and to resolve situations where the weighting of services cannot be undertaken reliably. These proposals are to (1) add a practical expedient for situations where applying the existing guidance on coverage units is unduly complex or the relative weighting of different services cannot be measured reliably, and (2) revise IFRS 17.117 to modify the requirement for the relative weighting of different services.

The member presenting the paper noted this issue had been communicated to the IASB, and that it is particularly pertinent given the prevalence of bundled services in Asia and the potential that there may be incomparability amongst entities if there is not a well-understood method by which to determine coverage units and the relative weighting of benefits. This member commented that although the May 2018 TRG paper provided guidance about how to achieve the principle in IFRS 17 to reflect the services provided in the period, there is a large number of potential approaches that can result in varying outcomes, and that it has thus far been challenging for preparers in Hong Kong to develop an objective method.

This member suggested that the proposals in the paper are designed to contribute to improving comparability and operationality, and further commented that having clear guidance would ease the burden on preparers and auditors, and increase understandability for users.

The member presenting the paper suggested that an appropriate practical expedient for the sort of products presented in the paper would be a straight-line method based on the passage of time, and that policy count could be a reasonable measure for the quantity of benefits. This member also noted that the use of a passage of time approach was put forward early during the development of IFRS 17.

Most members agreed this was a complex issue for preparers, particularly in Asia due to the nature of contracts in the region, and it was noted this is a recurring topic for the HKIISG[2]. Several members agreed there is a lack of guidance in this area.

One member commented that the notion of needing to assess the quantity of benefits is fundamental to the concept of coverage units. This member noted that the paper illustrated well the variety of results that can be achieved by using different methods. This member noted that coverage units involve a determination of both quantity of benefits and a pattern of utilization, and that if the pattern is linear then a passage of time approach would be reasonable. The member questioned however how the passage of time would be determined for contracts with different quantities of benefits, and commented that breaking down groups into more homogenous groups would be a potential approach. If groups were sufficiently homogenous in terms of quantity of benefits, and a preparer was satisfied that the contract delivered services in a straight line pattern, then the number of policies in a group could be used to define coverage units. This member also commented that ultimately this will be a judgmental exercise.

One member agreed that it is practically challenging to determine the relative weighting of different services, and questioned whether it would be feasible to modify IFRS 17.117 to allow for a qualitative rather than quantitative disclosure. A couple of other members agreed that comparability and consistency is an important consideration, and that there is a risk of diversity in practice if applying only the principle in IFRS 17. One of these members stated that the guidance provided in IFRS 17 is not sufficient.

A couple of members questioned the scope of a potential practical expedient and whether it would become a “default” application or a “fallback” option. One member also questioned whether the introduction of a practical expedient would result in a situation where entities were still required to demonstrate that the full approach could not be performed without undue effort.

A few members commented that it is important for the IASB to adequately define investment-return services. One member commented that a key point for the definition of investment-return service is that it be applied consistently, such that

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[2] HKIISG 25/1/19 Paper 3 and 26/4/19 Paper 5

similar contracts should follow similar approaches.

A couple of members observed that although individual contracts may be subject to a straight-line method based on the passage of time, when aggregated to a group level the pattern would appear as a curve due to factors such as decrements. As such, the term “straight line” would technically only describe the individual contracts. Another member commented that regardless of the method employed, if there were heterogeneity in a group that would need to be reflected by some form of weighting.

A few members commented that they considered that the proposed disclosure requirement in IFRS 17.117 for relative weighting of services would not provide useful information and should be removed.

<u>Next steps</u>

The HKICPA staff will share members’ key comments during subsequent discussions with IASB staff as the IASB redeliberates the amendments to IFRS 17.

The HKICPA staff will also circulate this paper to some other national standard setters to see if they have encountered similar issues and have any views.