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

Meeting Summary
Hong Kong Insurance Implementation Support Group (HKIISG)
3 February 2021

Attendance

HKICPA representatives

Gary Stevenson, Financial Reporting Standards Committee (FRSC)
Cecilia Kwei, Director, Standard Setting
Tiernan Ketchum, Deputy Director, Standard Setting
Carmen Ho, 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
Sally Wang, Dajia Insurance Group
Kevin Wong, FWD Life Insurance Company (Bermuda) Limited
Abhishek Agarwal and Scott Ellis (representing Alexander Wong), HSBC Life
Steven To (representing Tracey Polsgrove), Manulife Asia
Wenhao Zhao, Ping An Insurance (Group)
Matsuta Ng, Prudential Hong Kong Limited
Joyce Lau, Target Insurance Company Limited
Francesco Nagari, Deloitte Hong Kong
Peter Telders, EY Hong Kong
Erik Bleekrode, KPMG China
Chris Hancorn, PwC Hong Kong

Guests

Marcus Chung, AXA China Region Insurance Company Limited
Brett Shadbolt, Censere
Eros Lau, Deloitte Hong Kong
Mateusz Lasik, Deloitte Hong Kong
Joe Ng, EY Hong Kong
James Anderson, KPMG China
Martin Friedhoff, KPMG China
Ian Farrar, PwC Hong Kong
Shelley So, PwC Hong Kong

Apologies

Alexander Wong, HSBC Life
Tracey Polsgrove, Manulife Asia

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 reconsidering their own implementation questions—but should note that the meeting summaries do not form any interpretation or guidance of HKFRS/IFRS 17.

1. Local submission: Application of fair value hedge accounting under IAS 39 for portfolio hedges of interest rate risk for insurance contract liabilities

This summary should be read in conjunction with the local submission (Paper 2). Please refer to the full submission for the detailed fact pattern and analysis.

The paper considers the application of the fair value hedge accounting model under IAS 39 *Financial Instruments: Recognition and Measurement* for portfolio hedges of interest rate risk arising from insurance contract liabilities. In particular, the paper considers how paragraphs AG114 to AG132 of IAS 39 can be applied to a portfolio of insurance contracts.

The papers analyses two approaches. The first approach considers that mortality risk is analogous to prepayment risk and applies paragraph AG121, and the second approach considers that mortality as analogous to credit risk and applies paragraph AG124. For each approach, the presence of ineffectiveness is analyzed, and each presents corresponding questions and views.

Approach 1 - Apply AG121 – mortality risk is akin to prepayment risk.

For Approach 1, the submission asks:

- Question 1 – Is the insured (i.e. mortality risk) akin to prepayment risk in mortgages (AG121)?
- Question 2 – Is there effectiveness for changes in timing of the cash flows due to the occurrence of the insured event (i.e. mortality)?
  - View 1 – Yes there is ineffectiveness – AG 126 needs to be followed.
  - View 2 – No, there is no ineffectiveness due to changes in cash flows as AG 121 applies (changes are uncorrelated to interest risk).

Among HKIISG members who commented on Approach 1, the following comments were noted:

- Overall, the members who commented had mixed views on whether mortality risk is more akin to prepayment risk or credit risk. A small majority of members indicated a preference for analogizing to prepayment risk.
- One member considered that mortality risk is not analogous to prepayment risk. Prepayment is by nature an acceleration in the maturity of a liability or asset, and

results in less periods of interest cash flows and earlier receipt of principal payments. This seems different in nature to an example (as discussed in the paper) of a life contingent annuity, which has a series of fixed cash flows associated with the survival of the insured person, and the risk is that a certain number of those cash flows fall away.

- One member made a general comment that based on the assumption that interest rate risk is separately identifiable and measurable, hedge accounting can be applied to insurance liabilities in principle. However, the member noted IAS 39 was not developed to cater specifically to hedging insurance-type liabilities. If hedge accounting under IAS 39 could be applied, however, the member's internal network considered that mortality risk is more akin to prepayment risk than credit risk. There are mixed views, however, as to whether View 1 or View 2 should be applied under Question 2 of Approach 1. One argument is that View 1 is appropriate as AG126 is related guidance. Another argument is that there are some differences between mortality risk and prepayment risk, in particular related to cash flows (e.g. when the insured event occurs, there would not be any future premium to be paid). Also, occurrence of a mortality event may not be analogous to prepayment risk because interest rate risk can affect prepayment risk.
- One member noted that large assumptions were being made on the overall applicability of hedge accounting to insurance contract liabilities. This member noted that within his network, there are different views on whether there is an interest rate component in insurance liabilities, and if you can meet the hedge accounting criteria. With regards to mortality risk, he would support Approach 1 (mortality risk is more akin to prepayment risk). He also analogized to the divorce risk that banks face on mortgages, which drives the prepayment pattern but is filtered out as it is not related to interest rate-driven prepayments. AG121 provides examples where changes aren't taken into account due to demographic factors, and here mortality risk can be seen as a demographic factor. For Question 2 View 2, of Approach 1, he also considers that there is practical difficulty related to reliably separating and disentangling changes when applying AG121's factors (a), (b) and (c).
- One member considered that mortality risk is more aligned to prepayment risk, and noted the similarity between where there is a stream of cash flows that ceases on prepayment in the case of a mortgage, or on death in the case of an annuity.
- One member considered that using insurance liabilities as a hedged item was quite novel in practice. The member noted there are three components, namely the assets (e.g. debt securities), derivatives (e.g. forward contracts or interest rate swaps), and liabilities, all of which are affected by interest rates. Typically in practice, the member used forward contracts and applied cash flow hedging to reduce profit or loss volatility (e.g. using forwards to lengthen asset duration to match better with liabilities). This member considers that mortality risk is more akin to prepayment risk, however, that they are not exactly the same and that prepayment risk is more like lapse risk.
- In response to the member above, one member considered that while insurers may wish to hedge on the asset side, it may not be easily achievable so some insurers are looking for alternatives.

Approach 2 - Apply AG 124 – mortality risk is akin to credit risk.

For Approach 2, the submission asks:

- Question 1 – Is the insured event (i.e. mortality risk) akin to credit risk in mortgages (AG 124)?
- Question 2 – is there ineffectiveness for changes in the timing of cash flows due to the occurrence of the insured event (i.e. mortality) and when it should be recorded?
  - View 1 - Yes, recognize ineffectiveness when the insured event occurs.
  - View 2 - No, recognise ineffectiveness when changes in expectations of the timing of the occurrence of the insured event impact the hedged risk.

Among HKIISG members who commented on Approach 2, the following comments were noted:

- One member noted that there were mixed views in his internal network as to whether the mortality risk should be analogized to prepayment risk or credit risk, however the slight majority would favor mortality risk being more akin on credit risk. For Question 2 of Approach 2, a slight majority from his internal network would favor View 2, where the ineffectiveness would be recognized when the changes in expectations of the timing of the insured event (i.e. mortality) occur. This is because waiting until the insured event occurs and then realigning the cash flows and recognizing ineffectiveness would not match with the fact that expectations of mortality have changed, and could lead to economic ineffectiveness before that.
- One member noted there may be some concerns on not recognizing ineffectiveness prior to the occurrence of the insured event, but overall did not have any additional comments because his internal network is not in favor of Approach 2.
- One member did not favor Approach 2 as he thinks that it is inappropriate to analogize mortality risk to credit risk. He noted that mortality risk is related to the contractual terms of the contract and contractual trigger for the settlements, whereas credit risk is related to a breach of a contract. He noted that his internal network has mixed views.
- One member agreed with the member above, and re-emphasized his view that mortality risk would be more akin to prepayment risk. However, this member would not prohibit an entity from taking the credit risk analogy. However, if one were to apply Approach 2, the member would apply View 2 and start recognizing ineffectiveness when changes in expectations arise.

2. Local submission: Impairment test for insurance acquisition cash flows

This summary should be read in conjunction with the local submission (Paper 3). Please refer to the full submission for the detailed fact pattern and analysis.

This paper considers the application of Amendments to IFRS 17 (the Amendments) which substantially revised the accounting for insurance acquisition cash flow ("IACF"). The amended text of IFRS 17 deleted paragraph 27, provided an expanded definition of what IACF can be allocated by introducing the allocation of IACF directly attributable to a group of contracts (IFRS 17:28B and IFRS 17:B35A(a)) and added guidance on how to perform the allocation (IFRS 17:28A and IFRS 17:B35A). The Amendments also introduced an impairment test in IFRS 17:28E to be carried out when facts and circumstances indicate that the assets may be impaired. The guidance on impairment is in IFRS 17:B35D.

The submission leverages on an illustrative scenario. As at 31/12/2024, the insurer computes its expectations of future net inflows from the portfolio to which the IACF assets relates to:

Net inflows from renewals of contracts initially issued in the year	Expected net inflows in 2025	Expected net inflows in 2026	Expected net inflows in 2027	Expected net inflows later than 2027
2024	100	70	70	70
2023	20	20	-	-
2022	10	20	-	-
Sub-total of net inflows from renewals by future year	**130**	**110**	**70**	**70**
New contracts net inflows				
Expected in 2025	90			
Expected in 2026		300		
Expected in 2027			300	
Expected later				400
Total net inflows by future year	**220**	**410**	**370**	**470**

Question 1 - Using the illustrative scenario above, how would an insurer interpret and apply the requirements of IFRS 17, para. B35D(a) ["first impairment test"] when performing the impairment test?

View 1 – "By column test". A separate impairment test should be performed for each of the IACF asset balances expected to be allocated to a future group by comparing the future net inflows from that future group of contracts to which it will be allocated to.

Applying View 1 to the example scenario above, as at the end of 31 December 2024, the impairment calculation is done as follows:

IACF asset B35A(a)	**Balance at 31/12/24**	*Expected allocation in 2025*	*Expected allocation in 2026*	*Expected allocation in 2027*
Generated in 2024	**100**	*40*	*30*	*30*
Generated in 2023	**50**	*30*	*20*	*-*
Generated in 2022	**30**	*20*	*10*	*-*
Sub-total (a)	**180**	***90***	***60***	***30***
IACF asset B35A(b)				
Generated in 2024	**200**	*50*	*60*	*90*
Generated in 2023	**150**	*50*	*60*	*40*
Generated in 2022	**130**	*20*	*40*	*70*
Generated in 2021	**60**	*20*	*30*	*10*
Sub-total (b)	**540**	***140***	***190***	***210***
Total (a) + (b)	**720**	***230***	***250***	***240***
Total net inflows by future year	**1,000**	***220***	***410***	***370***
Headroom / (Impairment)		***(10)***	***160***	***130***

This would result in an impairment loss of 10 currency units.

View 2 – "By table test". The impairment test for IACF asset should be performed by comparing the outstanding IACF asset balance for the portfolio against the future net cash inflows from that portfolio.

IACF asset B35A(a)	**Balance at 31/12/24**	*Expected allocation in 2025*	*Expected allocation in 2026*	*Expected allocation in 2027*
Generated in 2024	**100**	*40*	*30*	*30*
Generated in 2023	**50**	*30*	*20*	*-*
Generated in 2022	**30**	*20*	*10*	*-*
Sub-total (a)	**180**	*90*	*60*	*30*
IACF asset B35A(b)				
Generated in 2024	**200**	*50*	*60*	*90*
Generated in 2023	**150**	*50*	*60*	*40*
Generated in 2022	**130**	*20*	*40*	*70*
Generated in 2021	**60**	*20*	*30*	*10*
Sub-total (b)	**540**	***140***	***190***	***210***
Total (a) + (b)	**720**	***230***	***250***	***240***
Total net inflows by future year	**1,000**	***220***	***410***	***370***
Headroom / (Impairment)	**280**			

Under this view, there will not be a "first impairment test" loss for the year ended 31/12/2024.

Among HKIISG members who commented on Question 1 of Paper 3, the following comments were noted:

- There were mixed views. The majority of the members who commented supported View 1.
- One member considered that View 1 is technically more accurate, but operationally would prefer View 2. This member also questioned whether discounting needs to be considered, as Paper 3 implies no discounting is taking place. This member supported a no discounting approach as being consistent with IFRS 17:B35D, which uses the term "net cash inflow".
- In response to the comment on discounting above, another member (submitter of Paper 3) agreed that the Standard as currently written does not mandate discounting. This member noted that paragraph 32 of IFRS 17 requires discounting. Hence, net

cash inflows are discounted in line with the measurement principles of IFRS 17, but IFRS 17 is silent on whether cash flows are discounted to the impairment assessment date or the initial recognition date of each future group of contracts.

- One member showed more support for View 1 and noted that IFRS 17:BC184K makes references to “a group of contracts”, which is a singular term, as opposed to “groups” of contracts. He also thought that while IFRS 17:B35B states that the prospective allocation of the asset is not locked down and should be revised at each reporting date, he did not agree that the impairment test needs to be performed as a whole rather than its individual expected allocation amounts.
- One member also supported View 1, and noted the impairment test has to be performed at the same level as how it is determined and measured, which is at the level of the group in accordance with IFRS 17:B35A. This member put less emphasis on the argument of the wording of “group” versus “groups”.
- One member supported View 1 as he believes that it is correct way to interpret the Standard with reference to the group of contracts.
- One member supported View 1 because IFRS 17:B35D(a) makes reference to an asset and the related group, and then IFRS17:B35A requires allocation to a group, so then there needs to be one asset by group. As such, it is a group level test.
- One member (submitter of Paper 3) supported View 2 as he considers that the “first” impairment test in IFRS 17:B35D(a) is designed at the original level of aggregation for the IACF asset which is the portfolio of insurance contracts, and the net inflows calculated for the test would include both renewal net inflows for existing contracts in the portfolio and expected net inflows from new contracts that would be added to the portfolio in future periods. Additionally, the member noted IFRS 17:B35B states “at the end of each reporting period an entity shall revise amounts”, as such, the prospective allocation of the asset is not locked down and should be revised at each reporting date. He also considered that the information provided would be more useful and take into account cost-benefits considerations. In addition, he noted that results from a recent survey showed that in practice entities take into the account expected net inflows emerging from a future group when complying with IFRS 17:B35B.
- In response to the member above, one member noted that View 1 is cumbersome to apply and noted that View 2 would be easier to implement in practice.

Question 2 – Using the illustrative scenario above, how would an insurer interpret and apply the requirements of IFRS 17, para. B35D(b) ["second impairment test"] when performing the impairment test?

View 1 – "By column test". The unit of account for the first impairment test is aligned with View 1 for Question 1.

IACF asset B35A(a)	**Balance at 31/12/24**	*Expected allocation in 2025*	*Expected allocation in 2026*	*Expected allocation in 2027*
Generated in 2024	**100**	*40*	*30*	*30*
Generated in 2023	**50**	*30*	*20*	*-*
Generated in 2022	**30**	*20*	*10*	*-*
Sub-total (a)	**180**	*90*	*60*	*30*
Sub-total of net inflows from renewals by future year		***130***	***110***	***70***
Headroom / (Impairment)		***40***	***50***	***40***

View 1 would not recognise any "second impairment test" loss in 2024. The only loss recognised would be from the first impairment test (applying View 1) for 10 currency units.

View 2 – "By row test". The impairment test is performed for the total carrying amount of the IACF asset originating from each past group, or renewal group [original contract + future renewals of such contract]. As such, the second impairment test should mirror the guidance of IFRS 17:B35A(a)(ii).

IACF asset B35A(a)	**Balance at 31/12/24**	*Expected allocation in 2025*	*Expected allocation in 2026*	*Expected allocation in 2027*	**Headroom / (Impairment)[1]**
Generated in 2024	**100**	*40*	*30*	*30*	**210**
Generated in 2023	**50**	*30*	*20*	*-*	**(10)**
Generated in 2022	**30**	*20*	*10*	*-*	**-**
Sub-total (a)	**180**	***90***	***60***	***30***	

1 – Headroom/(Impairment) = IACF asset B35A(a) generated in, for example, 2023, less net inflows from renewals of contracts initially issued in the year, e.g. renewal group 2023.

Net inflows from renewals of contracts initially issued in the year	**Total net inflows for the second impairment test**	*Expected net inflows in 2025*	*Expected net inflows in 2026*	*Expected net inflows in 2027*	*Expected net inflows later than 2027*
Renewal group 2024	**310**	*100*	*70*	*70*	*70*
Renewal group 2023	**40**	*20*	*20*	*-*	*-*
Renewal group 2022	**30**	*10*	*20*	*-*	*-*

View 2 would recognise a "second impairment test" loss of 10 currency units in 2024. IFRS 17:B35D(b)(ii), however, requires that an impairment loss resulting from the "second impairment test" would only be recognised provided that it has not already been recognised as an impairment loss resulting from the "first impairment test". The insurer would need to determine the portion of the "second impairment test" loss that it would recognise in addition to the "first impairment test" loss.

Using the fact pattern, the "first impairment test" applying View 1 resulted in an impairment loss of CU10. Using a systematic and rational allocation method the portion of the "first impairment test" loss allocated to the IACF subject to the "second impairment test" is CU 3.9 ([90/230]*CU10). The allocation method used in this analysis is the relative carrying amount of the two types of IACF making up the total IACF asset balance expected to be allocated in 2025, the future year when the impairment is detected. This allocation approach is used for illustration purposes only.
The total impairment loss applying the combination of View 1 for the first impairment test and View 2 for the second impairment test is:

	CU
First impairment test loss	10
Second impairment test loss	10
Less portion already included in the first impairment test	-3.9
Total impairment loss for 2024	16.1

View 3 – “By cell test.” An IACF asset is an expected future allocation amount that needs to be tested only against the net inflows of the relevant future group of contracts thus breaking up the renewal group IACF asset in its expected allocation amounts for individual recoverability testing. With reference to the IACF asset originated by the 2023 group the second impairment test should be performed for each of the expected allocated amounts i.e. 30 expected to be allocated in 2025 and 20 expected to be allocated in 2026, against the net cash inflows for the expected renewals the respective future groups arising from contracts issued in the 2023 renewal group, i.e. expected net inflows of 20 in 2025 and 20 in 2026.

This view performs the second impairment test at the most granular level and would calculate the impairment as follows:

IACF asset B35A(a)	**Balance at 31/12/24**	*Expected allocation in 2025 and related net inflows*	*Expected allocation in 2026 and related net inflows*	*Expected allocation in 2027 and related net inflows*
Generated in 2024	**100**	*40*	*30*	*30*
Net inflows – Renewal group 2024	**240**	*100*	*70*	*70*
Headroom / (Impairment)		***60***	***40***	***40***
Generated in 2023	**50**	*30*	*20*	*-*
Net inflows – Renewal group 2023	**40**	*20*	*20*	*-*
Headroom / (Impairment)		***(10)***	***-***	***-***
Generated in 2022	**30**	*20*	*10*	*-*
Net inflows – Renewal group 2022	**30**	*10*	*20*	*-*
Headroom / (Impairment)		***(10)***	***10***	***-***

This view would recognise a "second impairment test" loss of 20 currency units in 2024. In applying IFRS 17: B35D(b)(ii), the insurer determines the portion of the "first impairment test" loss of CU10 using a systematic and rational allocation method the portion of the "first impairment test" loss allocated to the IACF subject to the "second impairment test" is CU 3.9 ([90/230]*CU10). The allocation method used in this analysis is the relative carrying amount of the two types of IACF making up the total IACF asset balance expected to be allocated in 2025, the future year when the impairment is detected. This allocation approach is used for illustration purposes only.

The total impairment loss to be recognised in 2024 is CU26.1, calculated as follows:

	CU
First impairment test loss	10
Second impairment test loss	20
Less portion already included in the first impairment test	-3.9
Total impairment loss for 2024	26.1

Among HKIISG members who commented on Question 2 of Paper 3, the following comments were noted:

- Members who commented on Question 2 of Paper 3 had mixed views.
- One member (submitter of Paper 3) was of View 2 for the reasons presented in the submission.
- One member commented that View 1 is technically more accurate based on the Amendments. This member also noted that View 2 and 3 require tracking the assets by issue year, and considered this is not required by Standard. However, this member considered that View 2 of Question 1 is preferred as it is operationally easier to perform.
- One member noted mixed support for View 1 and View 2 in his internal network, but did not see any basis for View 3. However, he considered that View 1 is more in line with the requirements of the Standard.
- One member also noted that there were mixed support for View 1 and View 2 in his internal network, with a tendency towards View 2. Similar to the member above, this member would support View 1 given his support for View 1 in Question 1. This member did not think that View 3 should be prohibited, but noted that View 3 involves granular calculations and would therefore be tedious to implement in practice.
- One member supported for View 1, and noted that both cash flows and acquisition costs are only for renewals. However, his internal network showed support for View 2. Furthermore, this member considered that View 3 would not be prohibited.
- One member supported for View 1, and noted that the Standard would not prohibit View 2 or View 3. However, he noted that View 2 and View 3 will bring additional complexity to the insurer to keep track of the assets. This member also commented on when the impairment test can be done at higher level (e.g. as in View 2 of Question 1 on the portfolio level). Noting the requirements of B35B, the member considered that if the impairment test is done at a portfolio level, there may be more than one CSM group. Hence, if certain expenses are tracked on a bottom-up level (e.g. commission paid for a hypothetical CSM group A), but then reallocation and impairment is done on a portfolio level, the commissions paid on CSM Group A could be reallocated to CSM Group B within the same portfolio. Hence, while this member supported View 2 for Question 1, it was considered that there should be further assessment of how the IACF is considered on a top-down or bottom-up level.
- A member, in response to the comment immediately above, commented that View 2 on Question 2 could be taken, but that the Standard uses the words “groups of contracts”, and hence View 1 should be allowed. If an entity wanted to do a more granular exercise, View 3 could be taken, but View 3 is not required by the Standard.
- A member (the submitter), in response to the two comments immediately above, commented that the Standard requires this test to be done in a way that calculates expected renewals, and which looks at the allocation of insurance acquisition cash flows against expected renewals for the related assets and related groups (with an emphasis on the plurality of assets and groups). As such, this member considered View 1 as not compliant or aligned with the wording of the Standard, and the only feasible approach was View 2 (by row) or a Question 1 equivalent to View 1 (a combination of rows and columns, effectively on a by cell basis). This member’s network expressed no support for View 3, in line with the member’s view on Question 1. The member questioned how an entity could conclude that it did not have to test the recoverability of a group of contracts that initially generated the asset, because if that

was not done, the entity would effectively allocate some expenses (e.g. commissions) to renewals that had nothing to do with the original contracts that generated those commissions. The member considered that the intent of this second test is to test the new asset specifically, and the sufficiency of the renewals to recover multi-year commissions paid when acquiring a contract from a new policyholder.

- In response, a member commented that support for View 1 could be found in paragraph A9 of the IASB staff paper attached to Paper 3 (December 2019 AP 2B). Additionally, IFRS 17:B35D was considered to support View 1, and align with Question 1 View 1 as well.
- In response, another member also commented that "related assets" in IFRS 17:B35D could be interpreted as being in compliance with the "by column" approach in View 1, as it would relate to each column of 2025, 2026, 2027.
- In response to this, a member (the submitter) argued that whereas for the first impairment test the Standard's wording is singular, for the second impairment test the wording is plural. As such, View 1 of Question 1 is incompatible with View 1 of Question 2. View 2 of Question 1 however would be compatible with View 1 of Question 2.
- One member further questioned whether revising the prospective IACF allocation must be done for each valuation period, or if the allocation is locked when the asset is established.
- A member (the submitter) responded affirmatively and noted the wording in paragraph B35B that "an entity shall revise".

3. Local submission: Allowance for income taxes in fair value measurement

This summary should be read in conjunction with the local submission (Paper 4). Please refer to the full submission for the detailed fact pattern and analysis.

The purpose of Paper 4 is to facilitate discussion on how preparers are currently allowing for Hong Kong taxes when determining the fair value measurement of insurance contracts for deriving the CSM under fair value approach (FVA) as at transition date.

The submission seeks views across three scenarios:

1. Where Section 23 taxes are payable on a premium based approach
2. Where Section 23 taxes are payable on an adjusted surplus approach
3. Differences in approach where Section 23 taxes are specifically chargeable to the policyholder

Views are also sought on taxes other than those payable under Section 23 of the Inland Revenue Ordinance (Question 4).

Question 1 – Where Section 23 taxes are payable on a premium based approach

How are different preparers allowing for income taxes in the fair value measurement?

I. Not allowed for in any way
II. Explicitly forecast in cash flow projections
III. Allowed for in discount rate / expected return by adjusting these to be pre-tax
IV. Implicit / other approach

Question 2 – Where Section 23 taxes are payable on an adjusted surplus approach

How are different preparers allowing for income taxes in the fair value measurement?

I. Not allowed for in any way
II. Explicitly forecast in cash flow projections
III. Allowed for in discount rate / expected return by adjusting these to be pre-tax
IV. Implicit / other approach

Among HKIISG members who commented on Question 1 and 2 of Paper 4, the following comments were noted:

- Members who commented on Question 1 and 2 had mixed views.
- One member supported view III (allowed for in discount rate/cost of capital) for Question 1, 2, and 4. This member considered that market participants would take tax into account when assessing fair value. This member uses the cost of capital as implicit allowance for tax when fair value is measured. This member further considered that given fulfilment cash flows (FCF) is pre-tax, then cost of capital should implicitly allow for tax.
- One member considered that from IFRS 13 perspective, an entity could take either a pre-tax or post-tax approach. For consistency purposes, a pre-tax tax method would be preferred for fair value measurement because FCF under IFRS 17 are also calculated on a pre-tax basis.
- One member also firstly noted IFRS 13, and considered that market participants would take tax into account, so similar to the comments above, income tax should be allowed for in the fair value measurement.
- One member noted that practice has concluded that IFRS 17 requires taking a contract boundary perspective, and hence that IFRS 17 contract boundary perspective should be reflected in the fair value assessment, and that would be pre-tax. Hence, this member supported view I (not allowed for).
- One member also agreed with the above member that the application of the fair value measurement to the defined set of cash flows under IFRS 17 should be view I (pre-tax), as that is in line with the spirit and letter of the Standard. This member considered that IFRS 17's fair value approach at transition was designed specifically for IFRS 17 and restatement. Hence, the member considered that IFRS 17 set the framework in which fair value is adopted, and took precedence over IFRS 13. This member also noted that IFRS 13:B14(d) states that assumptions about cash flows and discount rates should be internally consistent.
- A member commented that the contract boundary argument may not necessarily be determinative for this issue. This member considered that the issue here is assessing a fair value of liabilities, and hence there are a variety of ways that this could be done. The method could be pre-tax or post-tax as long as measurement was consistent (consistency as required by IFRS 13), hence, if pre-tax cash flows were used, the discount rate would need to reflect that. This member did not see a need to link the fair value to how the IFRS 17 FCF are determined, as fair value could be determined via a variety of valid methods. The member also noted the taxation impact of insurance contracts is specific to an entity, so it was difficult to see how a reference to the taxation implications of a market participant could be considered if that was not the same for all market participants.

- A couple of members commented on consistency between IFRS 13 and IFRS 17 cash flows, and noted there are some differences between IFRS 17 cash flows (FCF) and discount rates which are entity specific, and those under IFRS 13 which are market participant based. One member noted that IFRS 17 FCF will have a selection of contractual cash flows (contractual benefit outflows and inflows) that are already consistent with market participants' views. Examples of differences may arise in expenses, FCF may include some entity-specific benefits, and discount rates may differ as IFRS 17 prohibits considering own-performance risk. There may be judgement involved. Another member noted that in Hong Kong, taxes are generally a percentage of premiums, so it is easier to determine the market participant's view.
- One member (the submitter) considered that entities should draw the line at the contract boundary when assessing the cash flows for inclusion. Additionally, entities may need to take into account unbundling considerations of IFRS 17. Once that had been done, this member would consider taxes as part of cash flows governed by IFRS 13 and a market participant's view, given that market participants would consider tax. The member noted a premium that an insurer may charge would be priced on a pre-tax basis, i.e. at a basis which allowed the settlement of the FCF (within IFRS 17) and payment of tax (outside of IFRS 17) to give a net profit. Hence, considering the IFRS 13 basis, market participants' views, and product pricing, making an allowance for taxes under a fair value measurement is more appropriate than not allowing for them. Under this view, IFRS 13 can be said to take precedence over IFRS 17. Then, as commented on above, there are a number of ways this fair value measurement could be done, and consistency is relevant.
- A few members discussed an example and noted that in the event the fair value is post-tax, an amount of CSM may be manufactured given that FCF are pre-tax. A simplified example was presented where an entity has a FCF outflow of $100, and would also need to settle $5 of tax, and hence the liability requires a total of $105 to discharge. If the fair value is done post-tax, a CSM of $5 would be manufactured as a result of the tax.
- One member commented that the notion a given IFRS Standard could limit the ability to take a certain fair value approach in IFRS 13 was difficult to understand, and that interplay between different Standards should not determine whether fair value measurement should be pre-tax or post-tax. The member made a comparison to impairment under IAS 36, which is biased towards pre-tax calculations, but where in practice most calculations are post-tax. The member considered that entities would need to consider what was most appropriate in the circumstance and apply judgement. Furthermore, this member noted that applying the notion of IFRS 13 "exit price" to this item may be overcomplicating the analysis, and that entities should consider it in terms of assuming a transfer of the liabilities (i.e. what would have to be paid for a party to assume the liabilities).
- A member noted that the IFRS 17 fair value approach is not supposed to be a fully accurate proxy of the retrospective approach, and hence applying the fair value approach may result in different consequences from applying the retrospective approach.

Question 3 – Where Section 23 taxes are specifically chargeable to the policyholder

Among HKIISG members who commented on Question 3, the following comments were noted:

- One member commented that the points previously made on Questions 1 and 2 regarding alignment with IFRS 17 cash flows would apply in the same way. That is, contractual cash flows that are part of the FCF and contractual terms would have to be valued at the transition date for restatement purposes.
- One member stated that these cash flows would form part of the calculation at transition date.

Question 4 – Treatment of taxes other than those payable under Section 23 of the Inland Revenue Ordinance

Among HKIISG members who commented on Question 4, the following comments were noted:

- One member commented that IFRS 17:B65 provides guidance on what are specifically chargeable to policyholder, for example, B65(i) on transaction-based taxes and levies. If these cash flows are captured as part of the fulfilment cash flows, then the fair value at transition should reflect that. For this member, the same principles as applied under prior questions would hold under Question 4.
- One member (the submitter) commented that where an entity aligns with IFRS 17 measurement or not on this issue is difficult. This member suggested that it would be unlikely for a market participant to identify taxes other than corporate or profits taxes, and incorporate those into their prices assumptions, if those other types of taxes weren't part of the FCF. As such, this member wouldn't see items like withholding taxes as being a part of the fair value measurement.
- A member commented that an issue would arise only if these amounts did not form part of the FCF, but where they still would form part of what market participants would consider when determining fair value. It is hence important to look at the average market price and how a market participant would view the transaction. Tax may be an important consideration when arriving at fair value. This member used a cost of capital approach to ensure consistency.