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IFRS 17 TRG: 26-27 September 2018

Summary of Agenda Papers

Francesco Nagari, Deloitte Global IFRS Insurance Leader

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Agenda

Summary of the TRG 26-27 September papers 1 to 11

1. Insurance risk consequent to an incurred claim
2. Determining discount rates using a top-down approach
3. Commissions and reinstatement premiums in reinsurance contracts issued
4. Premium experience adjustments related to current and past service
5. Cash flows that are outside the contract boundary at initial recognition
6. Recovery of insurance acquisition cash flows
7. Premium waivers
8. Group insurance policies
9. Industry pools managed by an association
10. Annual cohorts for contracts that share in the return of a specified pool of underlying items
11. Other submissions

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Insurance risk consequent to an incurred claim – paper 1

Profit emergence when coverage exist after claims are incurred

- The fact pattern refers to an insurance contract that has similarities with Personal Income Protection products designed to insure the risk that an individual in an income generating activity may suffer an accident that would disable his ability to carry out the activity
- These contracts have a long contract boundary and very frequently have regular premium payments that the policyholder makes over the coverage period
- The contract analysed in the paper assumes that some of the insured events that cause the individual to be unable to carry out the activity may have a temporary adverse impact on the policyholder
- When the policyholder reports the insured event, he is entitled to benefits including the suspension of the payment of premiums otherwise due
- When the adverse effects of the insured event are no longer present (e.g. the policyholder has received rehabilitating treatments and can return to his income generating activity) the policyholder should continue to pay premiums to maintain the coverage in place for another future adverse event
- Whether or not a policyholder will recover from the adverse impact of the insured event is matter of estimation by the insurer

Implementation question: is the occurrence of an insured event during the coverage period an incurred claim given the insurance coverage could restart?

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Insurance risk consequent to an incurred claim – paper 1 (cont.)

Profit emergence when coverage exist after claims are incurred

- The paper suggests that there is a special type of insurance risk that is caused by the occurrence of an insured event
- Such insurance risk is referred to as **"consequential insurance risk"** for which the insurer stands ready
- The risk is the discovery of the ultimate cost of the benefits due following the logic of IFRS 17 paragraph B5 on the stand ready obligation that an insurer may accept to compensate the other party for adverse development on an event already occurred
- To be noted that paragraph B5 refers to "an event" rather than "an insured event"
- The alternative view is that the occurrence of an insured event always results in the recognition of a liability for incurred claims

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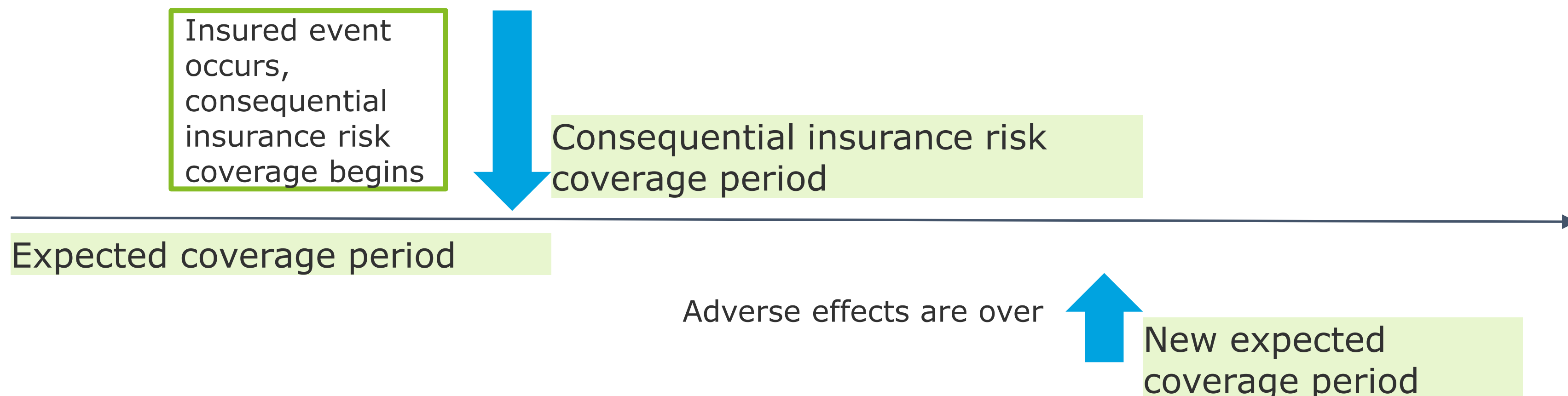
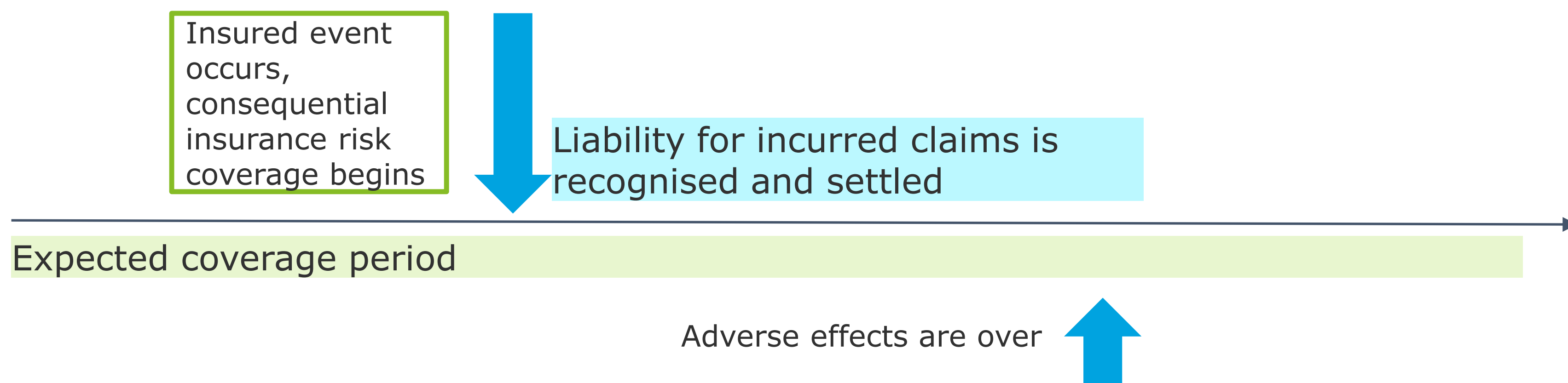
Insurance risk consequent to an incurred claim – paper 1 (cont.)

Profit emergence when coverage exist after claims are incurred

- View A – there is consequential insurance risk



- View B – consequential insurance risk is not considered



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Insurance risk consequent to an incurred claim – paper 1 (cont.)

Profit emergence when coverage exist after claims are incurred

- IASB Staff concluded that this is **a matter for judgment** as to which interpretation of A or B provides the most useful information about the insurance service provided by the entity to the policyholder under the contract
- Examples considered to illustrate A or B:
  - Disability insurance; and
  - Fire insurance

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Determining discount rates using a top-down approach – paper 2

Impact of changes in the assets used as the reference portfolio

- The principles on the calculation of the discount yield curve allow the use of the insurer's own financial assets as the reference portfolio to determine the curve
- IFRS 17 also requires the insurer to calculate the required "top-down" adjustments to reflect the characteristics of the insurance contract cash flows that need to be discounted

Implementation question: what is the impact on the discount rate from the inclusion of more or less illiquid assets in the reference portfolio derived from the actual assets held?

- **View A** – changes in the assets held should not change the discount rates if the liquidity characteristics of the contracts are not changed; or
- **View B** – changes in the assets held could impact the discount rate subject to the relevant "top-down" adjustments
- The IASB Staff concluded that view B is appropriate and explained that **the "top-down" adjustments should include, among other adjustments, the adjustment for "differences in liquidity characteristics of the insurance contract and the reference portfolio"**

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Commissions and reinstatement premiums in reinsurance contracts issued – paper 3

Presentation in the insurance revenue or the insurance expense line of the profit or loss

- Ceding commissions are categorised in two types:
  - Contingent on claims or
  - Not contingent on claims

Implementation question 1: for each type of commission is the presentation in the insurance revenue or insurance expense line?

Implementation question 2: can these commissions meet the definition of acquisition costs?

Implementation question 3: when would an investment component be present if a reinsurance contract has ceding commissions?

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Commissions and reinstatement premiums in reinsurance contracts issued – paper 3 (cont.)

Presentation in the insurance revenue or the insurance expense line of the profit or loss

- Reinstatement premiums are considered under two categories:
  - Mandatory, or
  - Voluntary

Implementation question: how should reinstatement premiums be presented in the profit or loss?

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Commissions and reinstatement premiums in reinsurance contracts issued – paper 3 (cont.)

Presentation in the insurance revenue or the insurance expense line of the profit or loss

- **Ceding commissions not contingent on claims** have an economic effect equivalent to a lower premium from the reinsurance contract. Based on this the IASB Staff concluded that they should be **part of the insurance revenue presentation as a deduction from the premium amount** that the form of the contract indicated to be due by the cedant
- **Ceding commission not contingent on claims and non-refundable** are still **part of the insurance revenue presentation as a deduction from the premium amount** and they would make the reinsurance contract issued onerous if the reinsurer does not expect a sufficient volume of cessions to be in excess of the unavoidable cash outflow
- **Ceding commission not contingent on claims** are an investment component if and only if they are **repaid** to the cedant in **all circumstances**
- **The commissions paid upfront to the cedant and non-refundable are not an investment component because there is no repayment of cash previously received**

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Commissions and reinstatement premiums in reinsurance contracts issued – paper 3 (cont.)

Presentation in the insurance revenue or the insurance expense line of the profit or loss

- **Payment of ceding commissions contingent on claims** have an economic effect equivalent to a higher claim incurred from the reinsurance contract. Based on this the IASB Staff concluded that they should **be part of the insurance expense presentation as an addition to the claim amount** that the form of the contract indicated to be due to the cedant
- **Ceding commission contingent on claims** are an investment component if and only if they are **repaid** to the cedant in **all circumstances**

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Commissions and reinstatement premiums in reinsurance contracts issued – paper 3 (cont.)

Presentation in the insurance revenue or the insurance expense line of the profit or loss

- **Reinstatement premiums that are mandatory are always contingent on claims.** They have an economic effect equivalent to a lower claim incurred from the reinsurance contract. Based on this the IASB Staff concluded that they should **be part of the insurance expense presentation as a deduction from the claim amount** that the form of the contract indicated to be due to the cedant
- **Reinstatement premiums that are voluntary are never contingent on claims.** They have an economic effect equivalent to an additional premium paid to extend the coverage beyond the occurrence of a claim. Based on this the IASB Staff concluded that they should be **part of the insurance revenue presentation**
- The appendix to the paper presents two additional cases:
  - Profit commission; and
  - Retrospective premium adjustments

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Premium experience adjustments related to current and past service – paper 4

When an experience variance from premium must be reported in profit or loss, if ever?

- The paper considers the experience variance for premiums that relates to past or current periods (e.g. premium adjustments to reflect the actual coverage received in a past period) and those related to future periods (e.g. caused by lapse behaviours)

Implementation question: When an experience variance from premium must be reported in profit or loss, if ever?

- The IASB Staff concluded as follows
  - Experience variances from events like retrospective premium adjustments will be reported in profit or loss because they do not refer to future coverage periods; and
  - Experience variances from lapse behaviours would adjust the CSM (see B96(a)) or adjusts the LfRC under the PAA

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Cash flows that are outside the contract boundary at initial recognition – Paper 5

The reassessment of the contract boundary is only for changes in the practical ability to fully reprice the risks

- The paper considers the situations where the contract boundary is shorter than what would be the legal duration of a contract e.g. when the issuer has the unconditional right to fully reprice with a 90 days notice but the policyholder/cedant is compelled to pay for a longer period of time if the issuer does not exercise that right

Implementation question: is the reassessment of the contract boundary also considering the assessment of whether or not the issuer has exercised its repricing option that would fully reprice the risks?

- Options to reprice fully the risks are integral to the requirements of paragraph 34 (at individual policyholder level for 34(a) and at portfolio level for 34(b))
- The IASB Staff concluded that **the reassessment of the contract boundary in paragraph B64 must not include the assessment of whether or not the option to reprice has been exercised or not**. Any event occurring beyond that point would be a new contract under IFRS 17 even if they come from a single legal contract
- **The reassessment required in paragraph B64 is solely focused on changes surrounding the practical ability to fully reprice**

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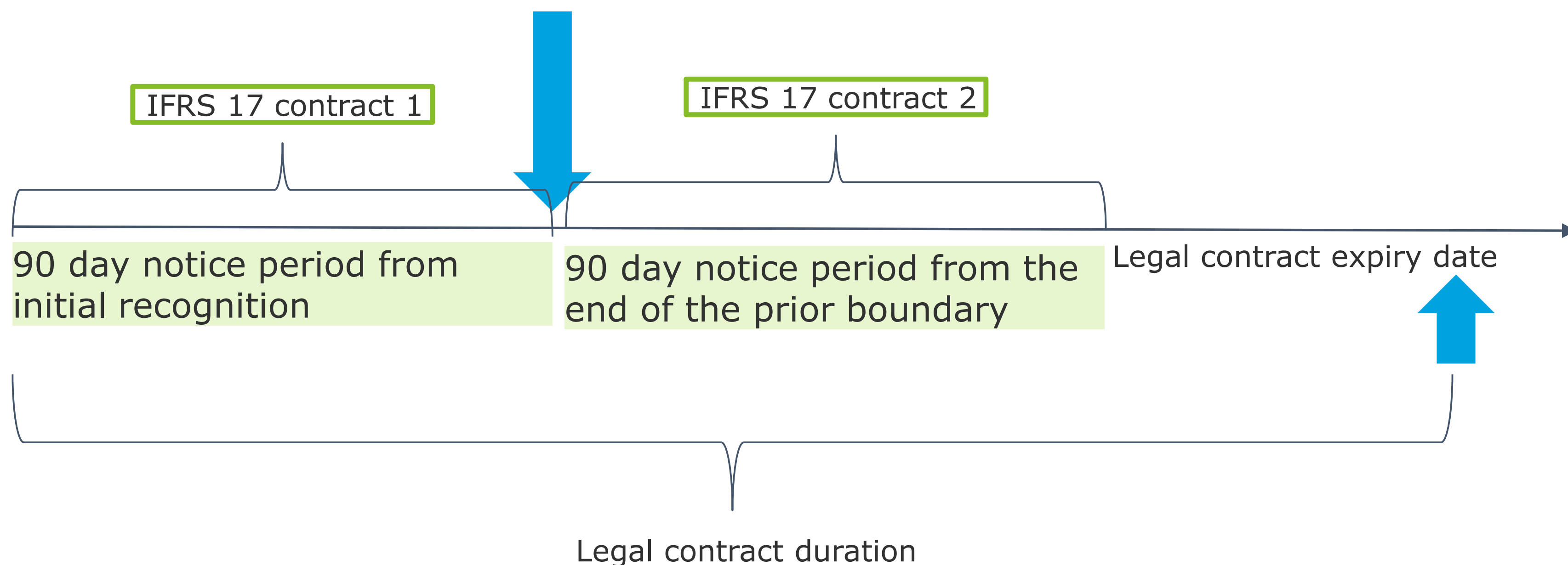
Cash flows that are outside the contract boundary at initial recognition – Paper 5 (cont.)

The reassessment of the contract boundary is only for changes in the practical ability to fully reprice the risks

- Example of a reinsurance contract with a 90 days notice for full repricing



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Recovery of insurance acquisition cash flows – Paper 6

Confirmation of the accounting for the impact of changes in acquisition costs

- The analysis consider the possible relationship between inflows and acquisition costs (AC)

Implementation question 1: is there an implicit recoverability of acquisition expenses from the inflows expected from the group of contracts?

Implementation question 2: how should changes in assumptions and experience variances from acquisition costs be accounted for?

- IASB Staff concluded that

a) Any reduction in CSM or increase of LC because premiums are lower than outflows will impact insurance revenue;

b) Changes in the expectations of AC adjusts the CSM and are reflected in insurance revenue and expenses according to paragraph B125; and

c) Experience adjustments related to AC affect insurance revenue based on paragraph B123 and B125 and insurance expenses according to paragraph B125

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Recovery of insurance acquisition cash flows – Paper 6 (cont.)

Confirmation of the accounting for the impact of changes in acquisition costs

- The IASB Staff also implicitly confirmed that the Loss Component includes only expected outflows
- The IASB Staff concluded an additional point on paragraph B65(h) indicating that those trail commissions described there are not AC under IFRS 17

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Premium waivers – Paper 7

Premium waivers do not qualify for exclusion in the contract classification test under IFRS 17

- The submission considers premium waivers when the policyholder is disabled or injured. Premiums are paid for another risk other than that associated with the waiver

Implementation question: is the waiver of a premium as a result of an uncertain event that occurred after the contract a condition that allows the entity to exclude the premium waiver from the IFRS 17 classification for significant insurance risk?

- The IASB Staff concluded that this clause relates to a pre-existing risk and although it may not be the primary insurance risk transferred to the insurer it is nevertheless insurance in nature
- The contract classification would include this set of cash flows. In addition, the entity would need to consider the associated insurance benefit (the waiver benefit) in calculating the coverage units to allocate CSM in profit or loss

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Group insurance policies – Paper 8

An example of the substance over form override of a single legal insurance contract and the application of contract boundary

- The submission considers group insurance for associations' members and credit insurance offered to borrowers of a bank

Implementation question 1: which party is the policyholder: the association/bank or the member/borrower?

Implementation question 2: if the insurer and the association/bank have a right to cancel all contracts to the members/borrowers with a 90 days notice, what is the contract boundary?

- The IASB Staff concluded that the **substance over form could apply to this type of insurance contract** and the individual member/borrower transfer or risk would be treated as a separate contract under IFRS 17
- The IASB Staff concluded that the boundary is 90 days given the insurer has full control on its stand-ready obligation and the members/borrowers cannot stop that decision to terminate coverage

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Industry pools managed by an association – Paper 9

Measuring the risk adjustment for insurance contracts in an industry pool

- The submission describes a risk association where insurers issuing motor insurance contracts have two pools in which they participate:
  - Pool 1 – in which some members are appointed to issue contracts on behalf of all of the members
  - Pool 2 – in which members of the association can choose to transfer some insurance contracts they have issued

Implementation question: is the association able to determine the risk adjustment on behalf of all the members or should it be done at individual member level?

- The IASB Staff concluded that **the first pool may need to be analysed under IFRS 11 as a joint venture (equity method) or a joint operation (share of assets, revenue etc.)**
- In relation to the second pool the IASB Staff suggests that **the association may have created a reinsurance contract with each member's decision to transfer**

Industry pools managed by an association – Paper 9 (cont.)

Measuring the risk adjustment for insurance contracts in an industry pool

- With regards to the calculation of the risk adjustment the IASB Staff appears to conclude that **the association would calculate it for the business in the first pool while individual members would calculate it for the business in the second pool**
- Regarding the extent of diversification benefits included in each calculation the IASB Staff note that there is a different interpretation among TRG members

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Annual cohorts for contracts that share in the return of a specified pool of underlying items – Paper 10

Identification of the conditions to unlock CSM of mutualised contracts without using the annual cohort

- The submission acknowledges the requirement of so called mutualisation and enquires on how they could be done in practice.

- ***Implementation question:*** There are three views commented in this paper:
  - View A – an entity is only able to unlock the CSM at portfolio level when policyholders share 100% of the returns from the underlying items;
  - View B – an entity is only able to unlock the CSM at portfolio level when policyholders share a specified percentage of the returns from the underlying items which is allocated back in a way that all existing policyholders share the amount pro-rata at the time of the allocation; and
  - View C – similar to view B but with an allocation back in a way that existing policyholders do not receive the allocation on a pro-rata basis

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Annual cohorts for contracts that share in the return of a specified pool of underlying items – Paper 10 (cont.)

Identification of the conditions to unlock CSM of mutualised contracts without using the annual cohort

- The IASB Staff noted that the submission has produced examples for View A and View B. View C is a more complex version of View B where the allocation is not done on a pro-rate basis
- The IASB Staff concluded that **when there is risk-sharing that is not fully applied to the returns of the underlying items the CSM of the contracts at group level (including the annual cohort dimension of the group) may be different from a CSM measured at a higher level, such as the portfolio level**
- This conclusion **appears to suggest that the IASB Staff favours a narrow view in the interpretation of the IFRS 17 requirements in paragraph B68 (and paragraph BC138 in the Basis for Conclusions)**

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Other questions submitted – Paper 11

Many banking products with significant insurance risk may have to be accounted for under IFRS 17

- There were a number of submissions that did not feature in individual agenda papers for the TRG meeting
- **Questions that can be answered by applying the words in IFRS 17**

1. Scope: Loan to buy a non-financial asset – IASB Staff responded by quoting the guidance of IFRS 4 Implementation Guidance. This guidance is not carried forward into IFRS 17 although the IASB Staff confirmed that the guidance is the same as in IFRS 4
2. Scope: Loan with repayment waiver on death – IASB Staff responded that this is likely to be an insurance contract
3. Scope: Credit cards providing its holder with coverage for a supplier failure – IASB Staff responded that this is likely to be an insurance contract
4. Scope: minimum EBITDA guarantee from hotel management service contracts – IASB Staff responded that this is likely to be exempted from the scope of IFRS 17
5. Scope: loans and other forms of credit with significant insurance components – IASB Staff confirmed they would be in IFRS 17 but IASB discussion will be held

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Other questions submitted – Paper 11 (cont.)

Clarification that only interim financial statements as defined under IAS 34 could trigger a different measurement in a group

- There were a number of submissions that did not feature in individual agenda papers for the TRG meeting
- **Questions that can be answered by applying the words in IFRS 17**

6. Measurement: interim financial statements – IASB Staff confirmed that only interim financial statements the meet the definition in IAS 34 would trigger the application of IFRS 17 paragraph B137. Other forms of internal or external reporting would not. The IASB Staff acknowledges that this could create differences between subsidiary and consolidated financial statements.

7. Measurement: actual crediting rate is different from expected and B96(c) – IASB Staff concluded that B96(c) only applies to experience variances associated with actual payments

8. Presentation: "separate accounts" presentation for assets and liabilities – IASB Staff noted that IAS 1 and IFRS 17 mandate certain line items in the statement of financial position. Sub-line items can be developed from that minimum presentation

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Other questions submitted – Paper 11 (cont.)

Contract boundary of the cedant and the reinsurer are the same

- There were a number of submissions that did not feature in individual agenda papers for the TRG meeting
- **Questions that can be answered by applying the words in IFRS 17**

9. Measurement: effect of a right to cancel a free additional coverage at any time embedded in a paid for insurance contract covering a different risk – IASB Staff concluded the cash flows from the free coverage are outside the contract boundary of the main contract and the accounting for that free coverage would begin when a claim is incurred given that the policyholder never pays a premium for it

10. Measurement: applicability of the non discounting exception to contracts under the general model – IASB Staff confirmed that, subject to materiality considerations, this exception is not available beyond contracts accounted for under the PAA

11. Measurement: contract boundary of cedant and reinsurer when rights are different – IASB Staff concluded that the boundary is the same even if the reinsurer has the right to reprice with 90 days notice that is not matched by an equivalent cancellation right by the cedant (see Paper 3 for a different fact pattern)

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Other questions submitted – Paper 11 (cont.)

Contract boundary extends beyond the coverage period

- There were a number of submissions that did not feature in individual agenda papers for the TRG meeting
- **Questions that can be answered by applying the words in IFRS 17**

12. Measurement: contract boundary and investment component – IASB Staff indicated the matter is clear and that contract boundary can extend beyond the coverage period

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Other questions submitted – Paper 11 (cont.)

Risk adjustment measurement of diversification benefits would not be debated again by the IASB

- **Questions that do not meet the submission criteria**

1. Measurement: significant possibility of becoming onerous – IASB Staff rejected the comment that this should be amended to be "significant probability" because of an alleged grammatical error
2. Measurement: designation of reinsurance contracts as hedging instruments for VFA – IASB Staff noted that IFRS 17 intended to limit this hedge accounting to derivatives
3. Measurement: different levels of diversification benefits allowed in the calculation of the risk adjustment between consolidated and subsidiary financial statements – IASB Staff appeared to confirm that the differences in views noted in the May 2018 TRG meeting were presented to the IASB in June and no further action seems to be planned

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Other questions submitted – Paper 11 (cont.)

The issue debated at the HKICPA IISG in its May and June meetings on coverage units has been rejected

- **Questions that are considered through a process other than a TRG discussion**

1. Mutual insurance companies – IASB Staff noted that a booklet with education material had been published in July 2018
2. Coverage units for indirect participating contracts – **This is the issue debated at the IISG in May and June 2018**. IASB Staff explained that the debate in the TRG meetings held in February and May 2018 have led to an amendment of IFRS 17 that IASB approved in June that will explain the treatment of investment-related services from an insurance contract. IASB Staff noted that examples 13 and 16 of the May TRG paper 5 are relevant to understand their decision on the submission

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