AcSB Insurance Transition Resource Group

Report on the Private Meeting

February 1, 2018

The Accounting Standards Board (AcSB) established the AcSB Insurance Transition Resource Group (TRG) to assist the implementation of IFRS 17 Insurance Contracts in Canada.

This document has been prepared by the staff of the AcSB and is based on discussions during the TRG's meeting. The meeting notes do not necessarily represent the views of the AcSB and nothing in them constitutes authoritative guidance.

The IASB staff papers referred to in the meeting notes were prepared by the IASB staff for discussion by the IASB® Transition Resource Group for IFRS 17 Insurance Contracts, and do not represent the views of any individual member of the IASB or its staff. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards.

ITEMS DISCUSSED AT THE FEBRUARY 1, 2018 MEETING OF THE ACSB INSURANCE TRANSITION RESOURCE GROUP (TRG) APPEAR BELOW. THE IASB TRANSITION RESOURCE GROUP FOR IFRS 17 MET ON FEBRUARY 6, 2018. THE WEBCAST AND MEETING REPORT FOR THAT MEETING CAN BE FOUND HERE.

Boundary of reinsurance contracts held (IASB agenda paper AP03)

Summary of the Paper

The IASB received a submission on how to read the IFRS 17 requirements on cash flows that are within the boundary of an insurance contract when applying them to reinsurance contracts held. The submission identified three factors that could be considered as having an impact on the assessment of the cash flows within the contract boundary for reinsurance contracts held:

(a) the ability of the reinsurer to exercise rights and have obligations similar to those described in paragraph 34 of IFRS 17;

(b) the right of the reinsurer to terminate coverage; and

(c) the rights and obligations of the holder of the reinsurance contract (sometimes referred to as the cedant).

For more details on the submission and the IASB staff analysis, please see IASB agenda paper AP03.

Summary of the Group's Discussion

The Group expressed concern about having to recognize cash flows for a contract that has not yet been written. Specifically, the Group discussed whether the contract boundary of a reinsurance contract held may include cash flows from future underlying contracts expected to be written by the cedant. The Group thought further distinction might be required for non-proportionate (based on loss retention up to a predetermined level) and proportionate (which premiums and losses are calculated on a pro-rata basis) reinsurance contracts.

For non-proportionate reinsurance contracts held, paragraph 62(b) of IFRS 17 requires the recognition of the contracts at the beginning of the coverage period, as the entity has exposure to future risks. For proportionate reinsurance contracts held, the participation of the reinsurer depends on the development of the underlying insurance contracts in force. The transfer of risks occurs when the underlying insurance contracts have been issued.

In addition, the Group was unclear whether the guidance in IFRS 17 on the contract boundary was to be read from the entity's or the reinsurer's perspective.

Separation of insurance components of a single insurance contract (IASB agenda paper AP01)

Summary of the Paper

The IASB received two submissions on this topic. The first submission related to whether IFRS 17 permits the separation of insurance components of a single insurance contract for measurement purposes. The submission noted that insurers combine different types of products or coverages that have different risks into one legal insurance contract. The submitter noted the following concerns relating to prohibiting the separation of insurance components within a single contract:

(a) Components that cover different risks that would otherwise be in different portfolios would be forced into the same portfolio.
(b) Components that cover different risks that would otherwise be in different measurement models (i.e., the general model and the premium-allocation approach) would be forced into one model.
(c) Profit that is related to the component with a shorter coverage period would be spread over the longer coverage period of a different component.

The second submission asked whether IFRS 17 would require a reinsurance contract held to be separated into components to reflect the underlying contracts covered for measurement purposes. The submitter provided an example of a reinsurance contract held that provides coverage to underlying contracts that are included in different groups of insurance contracts, and noted that applying the measurement requirements of IFRS 17 to the reinsurance contract as a whole could result in significant complexity and cost.

For more details on the submissions and the IASB staff analysis, please see IASB agenda paper AP01.

Summary of the Group's Discussion

The Group discussed whether guidance was needed in IFRS 17 on the separation of a contract. Focusing on the substance of the contract, there might be instances in which the separation of a contract into components might be reasonable for recognition and measurement purposes. For example, there might be facts and circumstances in which contracts are bundled together into one contract for convenience with no interdependences. In this instance, the entity could consider additional facts such as whether those risks are managed together to determine if separation is reasonable. However, requiring an entity to separate a contract in all situations could be restrictive and not allow for the use of judgment to reflect the substance of the contract.

Boundary of contracts with annual repricing mechanisms (IASB agenda paper AP02)

Summary of the Paper

The IASB received a submission about how to determine the contract boundary of insurance contracts with annual repricing mechanisms. The submitter asked whether the contract boundary of such contracts is one year or longer than one year (i.e., whether the cash flows used to measure the contracts would only be related to premiums up to their annual repricing date because the cash flows related to premiums after that date would relate to future contracts).

For more details on the submission and the IASB staff analysis, please see IASB agenda paper AP02.

Summary of the Group's Discussion

The Group noted that the fact pattern in the submission does not reflect contracts in Canada. However, the Group discussed facts and circumstances to consider when evaluating the substance of contracts with annual repricing mechanisms, such as the effect of options to renew and reprice on the duration of the contract, and whether the contract is underwritten.

Insurance acquisition cash flows paid on an initially written contract (IASB agenda paper AP04)

Summary of the Paper

The IASB received a submission on how to account for insurance acquisition cash flows unconditionally paid when a contract is first written by the entity ("an initially written contract"). In the fact pattern submitted, the entity:

(a) expects renewals outside the contract boundary to occur; and
(b) has written the new business with that expectation.

The submission describes three possible views on the treatment of cash insurance acquisition cash flows, in terms of the extent to which the cash flows should be considered in the measurement of the group to which the initially written contract belongs, and the measurement of the future groups to which the renewed contracts will belong.

For more details on the submission and the IASB staff analysis, please see IASB agenda paper AP04.

Summary of the Group's Discussion

The Group noted that the fact pattern in this submission was very narrow, but the broader issue is relevant to Canada.

The Group discussed the IFRS 17 definition of insurance acquisition cash flows, as well as paragraph 27 of IFRS 17, which states:

> An entity shall recognize an asset or liability for any *insurance acquisition cash flows* relating to a group of issued insurance contracts that the entity pays or receives before the group is recognised, unless it chooses to recognise them as expenses or income applying paragraph 59(a). An entity shall derecognise the asset or liability resulting from such insurance acquisition cash flows when the group of insurance contracts to which the cash flows are allocated is recognised.

The Group discussed two possible interpretations of this requirement:

1. Paragraph 27 of IFRS 17 permits an asset to be set up for acquisition expenses incurred before the recognition of the contract, without providing guidance on the method by which the asset is allocated to groups of contracts. The asset would need to be tested for impairment on a regular basis.
2. IFRS 17 permits insurance acquisition cash flows to be expensed under the premium allocation approach. There could be certain costs outside the scope of the fulfillment cash flows for insurance contract measurement under the general model that could lead to a similar accounting result.

Determining quantity of benefits for identifying coverage units (IASB agenda paper AP05)

Summary of the Paper

The IASB received a submission on how to determine the coverage units of a group of insurance contracts. The coverage units determine the amount of the contractual service margin to be recognized in profit or loss for services provided in a period. The submitter asked for clarification on the definition of "quantity of benefits" in paragraph B119 (a) of IFRS 17.

This IASB agenda paper addresses insurance contracts without investment components. The IASB Transition Resource Group for IFRS 17 will consider questions relating to insurance contracts with investment components at a future meeting.

For more details on the submission and the IASB staff analysis, please see IASB agenda paper AP05.

Summary of the Group's Discussion

The Group discussed the examples provided in paragraphs 14-16 of IASB agenda paper AP05. In particular, for the mortgage example in paragraph 14(b), the Group discussed the conclusion, in paragraph 16(b) of the agenda paper, that the coverage units would reflect the declining balance of the mortgage, but not the expected value of the property.

Members thought the conclusion in paragraph 16(b) did not support the conclusions in the remainder of the paper that the coverage units should reflect the contractual maximum level of coverage in each period. While the increase in property value should not be reflected in the coverage units, the Group thought the property value itself (based on, for example, long-term historical experiences of property values realized) should be reflected. It was also noted that mortgage insurance policies include coverage for mortgage default only and exclude coverage for physical damage beyond normal wear and tear whether caused by fire, earthquake or other hazard.

The Group also discussed the example, in paragraph 14(a) of the agenda paper, of a contract that provides coverage for fire damage up to CU50per year on a five-year construction project. The Group questioned the conclusion in paragraph 16(a); whether it was appropriate that the coverage units would reflect the constant maximum limit of CU50 for every period, because the risk associated with the coverage changes as the construction project progresses.

Insurance acquisition cash flows when using fair value transition (IASB agenda paper AP06)

Summary of the Paper

The IASB received a submission on the treatment of insurance acquisition cash flows that occurred prior to the transition date when the fair value approach to transition is applied. Specifically, if paragraphs B121(b) and B125 of IFRS 17 required the cash flows to be recognized as revenue and expense in the statement of financial performance for reporting periods subsequent to the transition date.
For more details on the submission and the IASB staff analysis, please see IASB agenda paper AP06.

Summary of the Group's Discussion

The Group agreed with the staff's conclusions in the paper and had no further comments.

Reporting on other questions submitted to the IASB® Transition Resource Group for IFRS 17 *Insurance Contracts* (IASB agenda paper AP07)

Summary of the Paper

This agenda paper summarizes other queries submitted to the IASB Transition Resource Group for IFRS 17. The submissions were categorized as queries 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 discussion by the IASB Transition Resource Group for IFRS 17 (such as a proposed annual improvement).

For more details on the submission and the IASB staff analysis, please see IASB agenda paper AP07.

Summary of the Group's Discussion

The Group discussed the following queries summarized in IASB agenda paper AP07.

S09 – Allocating the contractual service margin at the end of a period to coverage units

The Group discussed submission S09 taking into consideration paragraph 76(c) of IFRS 17 on derecognition and how that guidance applies to adjusting coverage units provided during the period. The following example was provided for context:

- Consider an entity with two contracts with a two-year flat-coverage period, totalling four coverage units. At the end of the first year, the entity amortizes two units in the contractual service margin, with the remaining two units to be amortized in the next year.
  - What happens if a contract lapses or deaths occur during the first year?
  - Is the contractual service margin amortized for the two units, with one unit remaining to be amortized in the next year?
  - Is the contractual service margin amortized for the three units (as the entity provided all the coverage for one contract), with one unit remaining to be amortized in the next year?

The Group thought that clarification was needed in this area for consistent interpretation in practice.

S23 – Premiums received applying the premium allocation approach

The Group discussed the practical issues around implementing this requirement and noted the same issue exists under the building-block approach. The issue is that cash-management systems would need to be set up to track premiums actually received in the period, separate from premiums due and expected. The Group thought the requirement to separately track premiums received might add another layer of complexity that will take time to implement and might not lead to useful information.

S03 – Presentation of groups of insurance contracts in the statement of financial position

The Group discussed whether this submission might have been considered if the IASB Transition Resource Group for IFRS 17 had widened its criterion to allow submissions relating to practical considerations, such as implementation costs. The Group questioned the current disclosure requirement in paragraph 78 of IFRS 17 to separately present in the statement of financial position the carrying amount of groups of:

- insurance contracts issued that are assets;
- insurance contracts issued that are liabilities;
- reinsurance contracts held that are assets; and
- reinsurance contracts held that are liabilities.

IFRS 17 requires insurance contracts to be netted. The Group questioned whether, from both the practical and financial statement user benefit standpoints, entities should then be required to break out the assets and liabilities for presentation purposes.