AcSB Insurance Transition Resource Group

Report on the Private Meeting

April 25, 2018

The Accounting Standards Board (AcSB) established the AcSB Insurance Transition Resource Group 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 Group's meeting. The meeting notes do not necessarily represent the views of the AcSB and nothing in them constitutes authoritative guidance.
The International Accounting Standards Board (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 April 25, 2018, meeting of the AcSB Insurance Transition Resource Group appear below. The IASB® Transition Resource Group for IFRS 17 *Insurance Contracts* met on May 2, 2018. The webcast and meeting report for that meeting can be found here.

Contract boundary for premium allocation approach
Reinsurance contract boundary
Educational materials
Boundary of reinsurance contracts held with repricing mechanisms
Combination of insurance contracts
Determining the risk adjustment for non-financial risk in a group of entities
Cash flows within the contract boundary
Determining the quantity of benefits for identifying coverage units
Implementation -challenges outreach report
Reporting on other questions submitted to the IASB Transition Resource Group for IFRS 17

Contract boundary for premium allocation approach (Canadian submissions to the AcSB Insurance Transition Resource Group)

Summary of the Paper

Two submissions were received on the issue of the contract boundary for the premium allocation approach: one relating to reinsurance contracts and the other to the provision of insurance without a defined contract.

The submission on reinsurance contracts noted that one possible interpretation of IFRS 17 is that the coverage period of a reinsurance contract that has been issued starts on the effective date of the specific reinsurance contract in question, and ends on its expiry date. This would result in the coverage period being inconsistent with the contract boundary term, as the end of the contract boundary could occur after the reinsurance contract's coverage period. The example provided is an issued, risk-attaching reinsurance contract. For such contracts, the expiry date of the last attaching policy determines the end of the contract boundary, which would be beyond the end of the coverage period for the reinsurance contract. The attaching policy is between the direct insurer and the policyholder.

The second submission discusses factors to consider in determining the contract boundary when the insurer is governed not by a conventional "policyholder-insurer" contract but by legislation. Relevant questions include:

(a) Is the entity required to provide coverage and can it compel its customers to pay premiums?

(b) How are the premium rates set?

(c) When does the entity have the "practical ability to reassess the risks" of the portfolio and reset the premiums paid?

(d) Are there any constraints to the entity's ability to set or reassess these premium rates?

The submission notes some complex or ambiguous areas that may act as potential constraints to the entity's practical ability to reassess risks.

Summary of the Group's Discussion

The Group noted that the contract boundary issue for reinsurance extends beyond the premium allocation approach, as described in IASB agenda papers AP03 and AP04. The Group discussed the coverage period for a risk-attaching reinsurance contract that has been issued. The Group discussed factors such as whether the reinsurer needs to consider future cessions when determining the contract boundary, and, if yes, which future cessions to consider, and whether new cessions, when subsequently added, would be treated as a new contract or as a modification of the current contract.

The coverage period is defined in IFRS 17 as the period during which the entity provides coverage for insured events. In the case of a one-year policy, the Group thought that the entity would consider the coverage period as two years to include the risk-attaching policy that continues into the second year. Therefore, to use the premium allocation approach, the entity would need to demonstrate (in accordance with paragraph 53(a) of IFRS 17) that this simplified method produces a result that would not differ materially from the result produced under the general model.

The Group discussed the second submission, whereby an insurer is governed not by a conventional "policyholder-insurer" contract but by legislation. The Group noted that all facts and circumstances need to be considered, including that legislation varies from province to province and therefore the contract boundary could also vary based on differing legislation. The Group noted that in determining the contract boundary, the entity would need to consider the point in time at which it has the legal right to reprice, independent of market pressures in existence at the time. One Group member noted the similarities between the fact pattern presented and IASB agenda paper AP03.

Reinsurance contract boundary (Canadian submission to AcSB Insurance Transition Resource Group)

Summary of the Paper

The submission raised several questions relating to the contract boundary for a reinsurance contract, including:

(a) Which cash flows for existing cessions,[1] and which cash flows for future cessions, should be included in the valuation of a reinsurance contract?

(b) As the contract extends (i.e., it is not cancelled by either party), how are the additional cessions treated? As part of the original contract or group of contracts, or as part of a new contract or group of contracts?

(c) If contractual rates are subsequently changed for a new business, through an amendment to the existing reinsurance treaty[2] rather than as a new reinsurance treaty, how does this impact the contract classification for accounting?

(d) If contractual rates are subsequently changed for a new business, and this is done contractually as an amendment to the existing treaty rather than as a new treaty, how does this affect the classification of the contract for accounting purposes?

(e) How are cedent recapture rights reflected in the cash flows and contract boundary?

Summary of the Group's Discussion

Group members noted that the issues related to contract boundary are not specific to reinsurance but are also shared by many direct insurance contracts.

The Group discussed the contract boundary for a reinsurance contract cancellable with a 90-day notification period by either party. The Group considered factors such as whether:

- the contract boundary was a rolling 90 days;
- each future cession could be viewed as a new contract, in which case a new contract is created each quarter; and
- each future cession could be considered a modification to the existing contract.

One Group member noted the inconsistency between the accounting for a reinsurance contract and the economics of the arrangement to the reinsurer if the interpretation is that only the cash flows for the 90-day period should be included in the valuation of the contract. The Group member provided a scenario of a contract written January 1 with a 90-day cancellation period. The chart below compares the results (i.e., actual versus estimated premiums) of applying the IFRS 17 requirements, with the economic substance of the reinsurance contract.

[1] Cessions refer to the portions of the obligation in an insurance company's policy portfolio that are transferred to a reinsurer.

[2] The term "reinsurance treaty" refers to the ceding company and the reinsurer negotiating and executing a reinsurance contract under which the reinsurer covers the specified share of all the insurance policies issued by the ceding company that come within the scope of that contract.

Quarter	Economic substance of the reinsurance contract	IFRS 17 requirements
1	One-quarter actual, three-quarters estimated	One-quarter actual, one-quarter estimated
2	Two-quarters actual, two-quarters estimated	Two-quarters actual, one-quarter estimated
3	Three-quarters actual, one-quarter estimated	Three-quarters actual, one-quarter estimated
4	Four-quarters actual	Four-quarters actual

The Group also discussed a concern with accounting for future cessions that have not yet been written but are within the boundary of reinsurance contracts. When measuring its direct contracts, the insurer is prohibited from including the cash flows of future contracts. However, when ceding a contract, the issuer has to project all cash flows within the boundary of the reinsurance contract held, which includes existing and future cessions. The reinsurer also has to project future cash flows for the underlying insurance policies that have not yet been written by the cedant (future cessions).

A Group member had difficulty reconciling this interpretation of the contract boundary with the guidance in IFRS 15 *Revenue from Contracts with Customers* that requires all aspects of the arrangement be considered when determining the measurement for revenue recognition.

Educational materials

Summary of the Paper

This agenda paper provided, for Group members' information, examples of publicly available, non-authoritative educational material that may assist with implementing IFRS 17. The materials include:

(a) European Financial Reporting Advisory Group's (EFRAG) "IFRS 17 *Insurance Contracts* and Level of Aggregation: A background briefing paper";

(b) EFRAG's "Background Briefing Paper: IFRS 17 *Insurance Contracts* and Release of the Contractual Service Margin";

(c) EFRAG's "Background Briefing Paper: IFRS 17 *Insurance Contracts* and Transition"; and

(d) KPMG's "Illustrative disclosures for insurers: Guide to annual financial statements: IFRS 17 and IFRS 9."

Summary of the Group's Discussion

The Group did not comment on this agenda item.

Boundary of reinsurance contracts held with repricing mechanisms (IASB agenda paper AP04)

Summary of the Paper

The IASB received a submission about how the boundary of a reinsurance contract held should be determined when the reinsurer has the right to reprice remaining coverage prospectively. In the submitted fact pattern, the reinsurer can:

(a) choose to exercise the right to reprice (the holder of the contract has the right to terminate coverage) or not exercise the right to reprice (the holder of the contract is committed to continue paying premiums to the reinsurer); and

(b) adjust premium rates at any time, subject to a minimum three-month notice period.

The submission described two possible views on how the contract boundary effects the contract holder’s substantive rights and obligations.

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 provided was straightforward, as the reinsurer has the right to reset premiums, triggering the contract holder’s right to terminate the contract. During its February meeting, the IASB Transition Resource Group for IFRS 17 observed that a substantive right to receive services from the reinsurer ends when the reinsurer has the practical ability to reassess the risks transferred to the reinsurer and can set a price or level of benefits for the contract to fully reflect the reassessed risk. However, the February discussion did not consider the fact pattern in which a substantive obligation to pay premiums to the reinsurer remains. The Group discussed and agreed with the view in agenda paper AP04 that as the right to terminate coverage is triggered by the reinsurer’s decision to reprice the reinsurance contract, it is not within the entity’s control and, as such, the entity has a substantive obligation to pay premiums to the reinsurer for the full duration of the underlying contract.

Combination of insurance contracts (IASB agenda paper AP01)

Summary of the Paper

The IASB received a submission about when a set or series of insurance contracts should be combined and treated as a whole, when applying paragraph 9 of IFRS 17. The submitter thought that the following factors could indicate that a set or series of insurance contracts is, in substance, a single contract:

(a) the contracts are priced as a single risk,

(b) the lapse of one contract changes the rights and obligations of the other contract(s); and

(c) measuring the contracts separately would result in one or some of the contract(s) being onerous; whereas when measured as a whole, the contract is profitable.

The submission observed that different views could be reached based on whether each of these factors is considered determinative when applying the requirements of paragraph 9 of IFRS 17.

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

Summary of the Group's Discussion

The Group thought that the entity would need to consider all the facts and circumstances to determine whether a set or series of insurance contracts is, in substance, a single contract. The Group discussed agenda paper AP01 at its February meeting, in which the reverse fact pattern was considered to determine if separation of a contract was required. The Group thought that by focusing on the substance of the contract, there could be instances in which the separation of a contract into components might be reasonable for recognition and measurement purposes.

Determining the risk adjustment for non-financial risk in a group of entities (IASB agenda paper AP02)

Summary of the Paper

The IASB received a submission about the level at which the risk adjustment for non-financial risk is determined:

(a) in the individual financial statements of the entities that are part of the consolidated group (i.e., parent and subsidiary entities that issue insurance contracts); and

(b) in the consolidated financial statements of the group of entities.

In the submitted fact pattern, at the individual entity level, the risk adjustment for non-financial risk reflects the compensation the entity requires for the groups of insurance contracts it issues. The risk adjustment does not reflect the degree of risk diversification that is available at the consolidated group level. The submitter asked:

(a) whether, in the individual financial statements of the subsidiary, the risk adjustment for non-financial risk for groups of insurance contracts issued by the subsidiary should reflect the degree of risk diversification available only to the consolidated group as a whole; and

(b) whether, in the consolidated financial statements of the group of entities, the risk adjustment for non-financial risk for groups of insurance contracts issued by entities in the group should reflect the degree of risk diversification available only to the consolidated group as a whole.

The submission provided three possible views on each on these questions.

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

Summary of the Group's Discussion

Some members thought that, similar to other notions of risk adjustment used (e.g., from a solvency objective of having adequate capital), under IFRS 17 an entity should be able to reflect the degree of risk diversification available at its level, which could be different for a consolidated group and its subsidiaries.

However, agenda paper AP02 expresses a view, based on relevant abstracts of IFRS 17, that the risk adjustment is meant to reflect the compensation that an entity would implicitly charge its clients to bear the non-financial risk of the contract. The paper also notes that the risk adjustment at the consolidated group level should be the same as the risk adjustment at the individual entity level, since determining the compensation that an entity would require for bearing non-financial risk is a single decision that is made by the entity that is party to the contract.

Group members noted that a local market will charge its clients the amount the market is able to bear. However, a company will decide whether to enter the market based on its pricing thresholds and hurdle rates.

The Group discussed the benefits of allowing judgment, based on facts, to determine whether to consider the degree of risk-diversification benefits available to a group of entities at both the individual entity and the consolidated group levels. The entity will need to demonstrate, from a governance perspective, the approach for reflecting the risk-diversification benefit in its pricing and how this approach should be reflected in the risk adjustment.

Cash flows within the contract boundary (IASB agenda paper AP03)

Summary of the Paper

The IASB received a number of submissions about the cash flows within the boundary of an insurance contract. Some of the submissions focus on how to apply the requirements in paragraph 34 of IFRS 17 regarding:

(a) the practical ability to set a price at a future date that fully reflects the risks of a contract or portfolio from that date; and

(b) options to add insurance coverage.

The IASB also received submissions seeking additional information about aspects that IASB Transition Resource Group for IFRS 17 discussed at its February 2018 meeting. Those submissions did not include any new information for consideration.

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

Summary of the Group's Discussion

Group members discussed aspects of the contract boundary in detail during the earlier discussion on the reinsurance contract boundary.

The Group agreed that a constraint that applies equally to new and existing contracts would not limit an entity's practical ability to reprice existing contracts to reflect their reassessed risks, as noted in paragraph B64 of IFRS 17. The entity would need to consider its substantive rights and obligations, whether they arise from a contract, law or regulation, to the extent that these substantive rights and obligations have commercial substance.

The Group agreed that an option to add insurance coverage is a feature of the insurance contract and that the measurement of a group of contracts should consider the substantive rights and obligations that arise from that option. As noted in agenda paper AP03, if the entity has the practical ability to reprice the whole contract when the policyholder exercises the option to add coverage, the cash flows related to premiums after the option exercise date would be outside the contract boundary. However, some Group members disagreed with the view in agenda paper AP03 on a scenario in which the entity has the practical ability to set prices for only the optional addition; that based on the facts and circumstances, such cash flows could be considered to be outside the contract boundary.

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

Summary of the Paper

At its February 2018 meeting, the IASB Transition Resource Group for IFRS 17 discussed a submission the IASB received 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 meaning of the term "quantity of benefits", referred to in paragraph B119(a) of IFRS 17.

Agenda paper AP05 from the February 2018 meeting addressed insurance contracts without investment components. This paper continues that discussion, including insurance contracts *with* investment components.

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 agreed that determining the quantity of benefits for identifying coverage units for insurance contracts without investment components should be based on judgment that reflects the insurance product and the entity's economic reality.

In regards to determining the quantity of benefits for identifying coverage units for insurance contracts with investment components, the Group observed that the contractual service margin is derived from all of the service provided (insurance and investment) and therefore the amortization of the contractual service margin should reflect this fact. The Group specifically discussed the recognition of the contractual service margin relating to deferred annuities. The amortization pattern of the contractual service margin would be distorted in the early years because no services are being provided.

Implementation challenges outreach report (IASB agenda paper AP06)

Summary of the Paper

This agenda paper reports comments from members of the IASB Transition Resource Group for IFRS 17 in response to IASB staff outreach on the following implementation concerns:

(a) presentation of groups of insurance contracts in the statement of financial position;

(b) premiums received applying the premium-allocation approach; and

(c) subsequent treatment of insurance contracts acquired in their settlement period.

The paper also reports information provided by members of the IASB Transition Resource Group for IFRS 17 on what they think would be useful information for financial statements users.

The IASB staff plan to provide the IASB with the implementation challenges outreach report at a future meeting.

For more details on this paper and the IASB staff analysis, please see IASB agenda paper AP06.

Summary of the Group's Discussion

The Group repeated comments from its February 2018 meeting about the practical issues raised by the disclosure requirement in paragraph 78 of IFRS 17 to present separately in the statement of financial position the carrying amount of groups of:

(a) insurance contracts issued that are assets;

(b) insurance contracts issued that are liabilities;

(c) reinsurance contracts issued that are assets; and

(d) reinsurance contracts issued that are liabilities.

The Group questioned how this presentation requirement aligned with the measurement requirement in IFRS 17 for groups of property and casualty insurance contracts to be netted.

The Group also discussed the rationale for netting, as offsetting is usually permitted for accounting purposes only when the entity has the legal right of offset (paragraph 42 of IAS 32 *Financial Instruments: Presentation*). This legal right is not present in the case at hand.

The Group considered the value added of providing a net presentation of an asset or liability at the group of insurance contracts level. Group members thought that net presentation at that level does not provide useful information to financial statements users. In terms of netting at, for example, the portfolio or entity level, some Group members considered that this would not detract from the users' ability to understand the transactions and to assess the entity's future cash flows.

The Group also agreed with the concerns raised in the outreach report about the implementation challenges in identifying premiums received related to groups of insurance contracts, such as the complexity involved, and the costs of developing changes to existing systems. The Group also discussed an alternative solution of applying an approximation approach for the allocation of premium receipts among the groups of insurance contracts.

The Group expressed concern on another topic in this agenda paper: the subsequent accounting for insurance contracts acquired in their settlement period. If the acquiring entity were to apply normal purchase accounting in accordance with IFRS 3 *Business Combinations,* the result would have the claims settlement flowing through the revenue line on the entity's financial statements. This would produce an unusual result for the pre-acquisition balances in the acquirer's financial statements. The result would also lead to claims incurred prior to the acquisition being accounted for differently than claims incurred post-acquisition.

Reporting on other questions submitted to the IASB Transition Resource Group for IFRS 17 (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 query summarized in agenda paper AP07:

S29 – Discount rate used in the allocation of insurance finance income or expenses to profit or loss. Group members noted that a single effective yield rate might produce measurement differences compared with using a yield curve.