AcSB Insurance Transition Resource Group

Report on the Private Meeting

September 17, 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 September 2018 meeting of the AcSB Insurance Transition Resource Group appear below. The IASB® Transition Resource Group for IFRS 17 *Insurance Contracts* met on September 26-27, 2018. The webcast and meeting report for that meeting can be found here.

Conversions under IFRS 17
Risk adjustment for worker's compensation boards
Insurance risk consequent to an incurred claim
Determining discount rates using a top-down approach
Commissions and reinstatement premiums in reinsurance contracts issued
Premium experience adjustments related to current or past service
Cash flows that are outside the contract boundary at initial recognition
Recovery of insurance acquisition costs
Premium waivers
Group insurance policies
Industry pools managed by association
Annual cohorts for contracts that share in the return of a specific pool of underlying assets
Reporting on other questions submitted to the IASB Transition Resource Group for IFRS 17

Conversions under IFRS 17 (Canadian submission to the AcSB Insurance Transition Resource Group)

Summary of the Paper

The submission raised the question on the treatment of conversions under IFRS 17. In Canada, conversions are common practice and are currently included within the best estimate cash flows. This paper explored the accounting requirements for conversions under IFRS 17, including which conversions might be included within the contract boundary and outside the contract boundary.

Summary of the Group's Discussion

The Group discussed practical approaches that comply with IFRS 17 for common types of conversion options in Canada.

Risk adjustment for the worker's compensation boards (Canadian submission to AcSB Insurance Transition Resource Group)

Summary of the Paper

The Alberta Workers' Compensation Board (WCB) made a submission, noting that the WCB insurance model differs from that of a traditional private insurer in Canada. The submitter questioned whether WCBs, as public sector insurers, require compensation for bearing risk and a risk adjustment for their insurance liabilities, based on the definition of "risk adjustment" in Appendix A of IFRS 17:

> The compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils insurance contracts.

Summary of the Group's Discussion

The Group noted that the submitter would need to consider the facts and circumstances of the insurance contracts that the entity issues. One consideration the Group discussed was whether the entity has the practical ability to reprice or recoup losses and whether any constraints exist in exercising that ability.

Some Group members agreed that a WCB could have minimal risk adjustments due to the entity's ability to reprice and recoup losses. Some group members noted that the legislative requirement on an entity's ability to reprice and recoup losses can vary across the country. However, the Group thought that the risk adjustment would typically be greater than zero because the uncertainty would not be eliminated completely even for the most risk-tolerant entity.

Insurance risk consequent to an incurred claim (IASB agenda paper AP01)

Summary of the Paper

The IASB received multiple submissions on insurance contracts under which an incurred claim results in insurance risk for the issuer that would not exist if no claim was made. One of the submitted fact pattern's is an insurance contract that provides coverage to a policyholder becoming disabled during a specified period. If a claim is made, the entity is required to make regular payments to the policyholder until the policyholder recovers, reaches a specific age or dies.

The submitters ask whether the entity's obligation to pay amounts subsequent to an incurred claim that are subject to insurance risk should be treated as:

(a) a liability for incurred claims; or

(b) a liability for remaining coverage.

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

Summary of the Group's Discussion

The Group agreed with the IASBs staff's view in AP01 to allow an accounting policy choice to treat an entity's obligation to pay amounts subsequent to an incurred claim subject to insurance risk as either a liability for incurred claims or a liability for remaining coverage.

The Group noted that management would need to choose the method that would provide useful information based on the facts and circumstances and the entity would need to apply the policy choice consistently. One Group member noted that some entities might have a challenge in applying the accounting policy choice consistency due to the nature of its business (e.g., an entity that provides both life and property and casualty insurance).

The Group also noted that there might be a disconnect in the case of reinsurance. For example, there might be circumstances that the underlying contract is treated as a liability for incurred claims and the reinsurance ceded is treated as a liability for remaining coverage.

Finally, the Group questioned how the disclosures would be applied as the accounting policy choice is at the portfolio level and disclosures are done in aggregation. Most Group members noted that the disclosure would be qualitative, stating whether the entity applied the liability for remaining coverage or the liability for incurred claims.

Determining discount rate using a top-down approach (IASB agenda paper AP02)

Summary of the Paper

The IASB received two submissions on how to apply the top-down approach to determine the discount rate for cash flows that do not vary based on the returns on underlying items.

The submitters ask whether:

(a) an entity could use the assets it holds as a reference portfolio of assets and ignore the liquidity characteristics of insurance contracts being measured; and

(b) changes in the assets the entity holds result in changes in the discount rates used to measure insurance contracts under specific circumstances.

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

Summary of the Group's Discussion

The Group noted that consistent with the discussion in IFRS 17.BC195, it is not appropriate to ignore the liquidity characteristics of the item being measured.

The Group also discussed what happens when the reference portfolio is based on actual assets the entity holds. It considered situations that a change in the market rate or a change in the composition of the group of assets held in the portfolio would occur. The Group also considered the treatment of credit risk under the two approaches.

However, the Group noted and agreed that while the top-down and bottom-up approaches could lead to different discount rates, the flexibility to choose the method for determining the appropriate discount rate should be retained.

Commissions and reinstatement premiums in reinsurance contracts issued (IASB agenda paper AP03)

Summary of the Paper

The IASB received several submissions relating to amounts exchanged between the issuer of a reinsurance contract (reinsurer) and the holder of the reinsurance contract (cedant).

The submissions describe both commissions that are contingent on claims and commissions that are not contingent on claims.

The submitters ask:

(a) for each type of commission, whether it is considered part of the premium or part of claims; and

(b) whether some or all the amounts related to these commissions meet the definition of insurance acquisition cash flows or an investment component.

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

Summary of the Group's Discussion

The Group discussed and agreed that the IASB staff's views expressed in AP03 were reasonable in terms of the accounting treatment of the various types of commissions. However, the result will affect the financial metrics an entity produces. The Group discussed the treatment of the experience rating refund business in Canada today and noted that revenue and claims might be lower under IFRS 17 because the amount recognized in revenue is limited to amounts above the refund basis. The Group also noted that the solution would be a matter of geography within the financial statements between revenue and expense.

One Group member raised a concern with the treatment of voluntary reinstatement premiums when the entity applies the premium-allocation approach. The concern was whether the entity would need to provide a revised estimate each reporting period as the expected revenue from inception might have changed. Some Group members commented that the additional cash flows would be captured in the premium receipts for the period.

Premium experience adjustments related to current or past service (IASB agenda paper AP04)

Summary of the Paper

The IASB received three submissions on how to account for differences between the expected and actual premiums (the premium experience adjustment), which relate to current or past service.

The submitters ask whether the differences should adjust the contractual service margin or be recognized in the statement of profit or loss immediately as part of either insurance revenue or insurance service expense.

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

Summary of the Group's Discussion

The Group agreed with the IASB staff's view in AP04 but discussed practical implications that arise when an entity receives an additional premium for future coverage during the current period that contains a portion related to the current period. The Group agreed that the entity needs to consider the facts and circumstances of the insurance contracts including materiality concerns.

Cash flows that are outside the contract boundary at initial recognition (IASB agenda paper AP05)

Summary of the Paper

The IASB received several submissions about the accounting for cash flows that are outside the boundary of an insurance contract at initial recognition.

The submitters question whether, and in what circumstances, either of the following requirements should be applied:

(a) Paragraph IFRS 17.35 discusses cash flows that are outside the boundary of the contract and relate to future contracts. Applying this requirement, cash flows outside of the boundary of a contract at initial recognition are cash flows of a new contract that is recognized and measured separately from the initial contract.

(b) Paragraph IFRS 17.B64 discusses the boundary of the contract that is reassessed at each reporting date and therefore, may change over time (e.g., it might be shortened or extended). Applying this requirement, cash flows that were outside the boundary of a contract at initial recognition can be reassessed as cash flows that are within the boundary at a later reporting date. Consequently, extending the boundary for cash flows that relate to future service adjusts the carrying amount of the contractual service margin of the group of contracts to which the contract belongs.

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

Summary of the Group's Discussion

The Group noted that the fundamental question in this paper is what constitutes a contract; whether it is the legal form or the substantive rights and obligations. Some Group members discussed that an entity would need to assess the legal form of the contract first then the substantive rights and obligations to determine the appropriate contract boundary.

Some Group members raised concerns that the fact pattern provided in this paper might create an inconsistency with the treatment of modifications in IFRS 17.
For the reinsurance fact pattern submitted, Group members discussed and agreed with the view expressed in the paper that the inclusion of future new cessions would be limited to 90 days. As IFRS 17.63 requires an entity to account for all future cessions within the contract boundary, the entity would have to forecast future cash flows of that 90-day period.
Group members also noted that the effect of quarterly reporting would need to be factored into the assessment of contract boundary.

Recovery of insurance acquisition costs (IASB agenda paper AP06)

Summary of the Paper

The IASB received two submissions related to the recovery of acquisition costs.
One of the submitters asks whether insurance acquisition cash flows and the related revenue are recognized in the statement of financial performance applying paragraph IFRS 17.B125 if those cash flows cannot be recovered from the cash flows of the portfolio of contracts.

The submitter described two interpretations:

(a) If the insurance acquisition cash flows are not recoverable, the portion of the premiums that relate to recovering those cash flows is nil, applying paragraph IFRS 17.B125; or

(b) The amounts related to insurance acquisition cash flows are presented as insurance revenue and insurance service expenses applying paragraph IFRS 17.B125 regardless of whether the group of insurance contracts is onerous.

The second submitter questions accounting for changes in insurance acquisition cash flows when applying paragraphs IFRS 17.B123 and IFRS 17.B125.

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

Summary of the Group's Discussion

The Group discussed IFRS 17.B125, which requires an entity to determine insurance revenue related to insurance acquisition cash flows by allocating the portion of the premiums that relate to recovering those cash flows to each reporting period in a systematic way based on the passage of time.

The Group also noted that IFRS 17.BC184 discusses that an entity must immediately recognize in profit and loss any acquisition cash flows that cannot be recovered from the portfolio of contracts. AP06 explains how to achieve this result by including all cash flows of the contract in the analysis and not by considering the recoverability of acquisition cash flows on a stand-alone basis.

Premium waivers (IASB agenda paper AP07)

Summary of the Paper

The IASB received a submission on whether terms in an insurance contract that waive premiums in specific circumstances create insurance risk.

The submitter asks whether the risk related to the premium waiver is a pre-existing risk of the policyholder transferred to the entity by the contract and is therefore an insurance risk, or a new risk created by the contract applying paragraphs IFRS 17.B11 and IFRS 17.B21.

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

Summary of the Group's Discussion

The Group agreed with the IASB staff's view in this paper, including that the definition of insurance risk has not changed from IFRS 4, *Insurance Contracts.*

Group insurance policies (IASB agenda paper AP08)

Summary of the Paper

The IASB received a submission regarding the boundary of a contract for an arrangement between an entity and an association or a bank (referred to as a "group insurance policy") under which the entity provides insurance coverage to members of an association or to customers of a bank.

Under a group insurance policy, an entity provides insurance coverage to members of an association or to customers of a bank (members or customers who purchase insurance coverage are referred to as "certificate holders").

The entity has a right to terminate the group insurance policy at any time with a 90-day notice period that, in turn, terminates the insurance coverage for all certificate holders.

The submitter asks whether cash flows related to periods after the 90-day notice period are within the boundary of an insurance contract.

For more details on the submission and the IASB staff analysis, please see agenda paper AP08.

Summary of the Group's Discussion

The Group discussed the unit of account for a group insurance policy and whether the group policy needed to be separated into multiple contracts with each certificate holder. It agreed that determination of the unit of account would require careful consideration of all facts and circumstances including the rights and obligations within the contract.

Industry pools managed by association (IASB agenda paper AP09)

Summary of the Paper

The IASB received a submission questioning the level at which the risk adjustment for non-financial risk should be determined for insurance contracts that are within industry pools managed by an association.
In the submission, all entities issuing automobile insurance contracts in a specific jurisdiction are required by law to be a member of an association. The association manages two types of industry pools:

(a) Pool 1—in which some members are appointed to issue contracts on behalf of all of members; and

(b) Pool 2—to which members can choose to transfer some insurance contracts they have issued.

For insurance contracts that are within either of the two industry pools described, the submitter asks whether the risk adjustment for non-financial risk should be determined at either:

(a) the association level; or

(b) the individual member level.

The submitter also asks whether the risk adjustment for non-financial risk could be measured differently in the financial statements of the members when compared to the financial statements of the association.

For more details on the submission and the IASB staff analysis, please see agenda paper AP09.

Summary of the Group's Discussion

The Group discussed this paper in relation to the comments provided on AP 02 from the May IASB TRG meeting. At that meeting, some IASB TRG members disagreed with the conclusion that the risk adjustment would be the same at both the consolidated group level and the individual entity level. Some Group members raised their concerns with requiring the risk adjustment of the group level to be applied at the individual entity level as the risk adjustment is meant to be entity specific.

The Group discussed the paper's implications for the Canadian property and casualty industry. For example, the law requires automobile insurers in Ontario to provide coverage to the facility pool. A Group member questioned whether the entity would be allowed to group contracts required by law with other contracts that are managed together based on similar risks if the entity is required to use the risk adjustment of the facility pool. Group members noted IFRS 17.20 that states contracts within a portfolio that would fall into different groups only because law or regulation specifically constrains the entity's practical ability to set a different price or level of benefits for policyholders with different characteristics, the entity may include those contracts in the same group.

The Group also discussed a common situation in Canada: various insurers sharing a pool of insurance contracts. However, the Group noted the structure of these arrangements is a shared pool rather than a pool with one entity controlling and reinsuring to the other parties. Therefore, the Group did not raise concerns with that type of arrangement.

Annual cohorts for contracts that share in the return of a specific pool of underlying assets (IASB agenda paper AP10)

Summary of the Paper

The IASB received a submission about annual groups of contracts with policyholders that all share in the return on a specified pool of underlying items, with some of the return contractually passing from one group of policyholders to another. The submitter observes that the return passing from one group to another could be a result of:

(a) guarantees;
(b) proportionate sharing in the returns of the pool; or
(c) contracts lapsing or expiring.

In the case of contracts lapsing or expiring, the return due to those policyholders was not paid out at the time; instead, it was accumulated and passed along to future annual groups of policyholders.

For those contracts, the submitter asks in what circumstances measuring the contractual service margin at a level higher than an annual cohort level (e.g., at the portfolio level) would achieve the same accounting outcome as measuring the contractual service margin at an annual cohort level applying paragraph IFRS 17.22.

For more details on the submission and the IASB staff analysis, please see agenda paper AP10.

Summary of the Group's Discussion

The Group noted that the fact pattern provided in the agenda paper is not common in Canada. Group members discussed whether participating contracts in Canada would be captured under the guidance in IFRS 17.B67. Some Group members thought that participating contracts could be out of scope and noted the rationale provided by the IASB in the Basis for Conclusions, IFRS 17.BC138.

Reporting on other questions submitted to the IASB Transition Resource Group for IFRS 17 (IASB agenda paper AP11)

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 AP11.

Summary of the Group's Discussion

The Group discussed the following queries summarized in agenda paper AP11:

S56 and S67 – Reporting frequency

The Group noted that if the entity reports quarterly and its subsidiaries report annually, this could lead to differences in accounting for the same insurance contract. This issue is important in Canada due to the quarterly reporting requirements.

S60 – Presentation of separate accounts

The Group agreed with the IASB staff response.

S62 – Coverage that an entity can cancel at any time

One Group member noted that this situation occurs in Canada and that it would be a change in current practice for when to account for the insurance liability.