TRG Minutes

Meeting information

AASB 17 *Insurance Contracts* Transition Resource Group (TRG)
23 April 2018
9am-2.30pm

Objective: The AASB 17 TRG was asked to review the agenda papers released by the IASB for discussion at the May 2018 IASB TRG and provide their comments on the issues to be shared at the IASB TRG meeting. TRG members reviewed all agenda papers prior to the meeting so that the meeting could be devoted to in-depth discussion of the issues. Each agenda paper was introduced by specific TRG members, who presented the TRG with an overview of the relevant issues and the expected impacts.

ATTENDANCE	ORGANISATION
Anne Driver (Chair)	QBE
Stephen Burton (via teleconference)	Suncorp
Louise Burns	EY (on behalf of Brendan Counsell)
Briallen Cummings	KPMG (on behalf of Ian Moyser)
Fehraz Fallil	icare
Joanne Gorton	Deloitte (on behalf of Stuart Alexander)
Scott Hadfield	PwC/AALC
Charles Hett (via teleconference)	NZASB
Chris Maher	AMP
Makoto Okubo (observer)	Nippon Life
Kris Peach (via teleconference)	AASB
Rachel Poo (observer)	QBE/Deloitte
Janri Pretorius (via teleconference)	AASB Staff
Grant Robinson	AMP/ Institute of Actuaries IFRS 17 Implementation Task Force
Paul Ruiz	Non-executive director
David Rush	Institute of Actuaries IFRS 17 Implementation Task Force
Rob Sharma	APRA
Richard Sheridan	Insurance Australia Group (IAG)
Warwick Spargo (via teleconference)	RSM Bird Cameron
Tony Tong	Pacific Life Re
Jeroen van Koert	AIA

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Topic	Agenda paper
Combination of insurance contracts	**AP01**
- Members observed that this was similar to the issue discussed at the February 2018 IASB TRG meeting around separation of insurance components of a single insurance contract. - One member raised a concern around how the principles would be applied to investment linked insurance riders, in particular whether the IASB staff view that "when the lapse or maturity of one contract causes the lapse or maturity of another contract, there is a strong indication that the contracts were designed to achieve an overall commercial effect", could result in investment and insurance contracts being required to be bundled together when they would otherwise be treated as separate contracts. In practice, the investment and insurance components may be issued as two separate contracts. In response, members noted that: o the current requirements of IFRS 17 around unbundling of investment and insurance components in a single contract [IFRS 17.32(b)] are narrower than the wording used by the staff in paragraph 20 of AP01 in relation to combination of separate contracts. IFRS 17.32(b) requires IFRS 17 to be applied to the combined investment and insurance components if the lapse or maturity of one component in a contract causes the lapse or maturity of the other; whilst paragraph 20 of AP01 states that it is only a "strong indication". o the conclusions presented in AP01 are in the context of combining of insurance contracts rather than insurance and investment contracts. o the "commercial effect" and substance of the contracts should be considered when determining whether contracts should be combined. - Members observed that the view presented in AP05 indicated that compelling reasons will be required to treat two contracts that are separate as a single contract. Some factors, such as the existence of a discount across product sets, is not enough to treat separate contracts as a single contract. - Overall, members supported the conclusions in AP01 in the context of combining separate insurance contracts. However, members agreed that if the principles were applied outside that scope, it could raise other issues for some life insurance products. It was agreed that clarity around application to investment linked insurance contracts would be sought within the Australian market and a paper will be drafted to assist this process and to determine if a paper to the IASB TRG is necessary	
Determining the risk adjustment for non-financial risk in a group of entities	**AP02**
- Members agreed with the staff conclusions that risk adjustment should be considered from the perspective of the issuing entity, i.e. the entity (or subsidiary) perspective should be considered. Risk diversification should be included in the entity risk adjustment to the extent it was considered by the entity when determining the compensation it would require for bearing non-financial risk. - One member noted that entities would need to consider the appropriate level of Probability of Adequacy (PoA) at the individual subsidiary level based on local entity expectation as well as the mix of PoAs within the Group required to achieve the appropriate risk adjustment at the consolidated Group level. It was also noted that the level at which the PoA and hence the	

risk adjustment is set for each entity could have an impact on the number of contracts being classified as onerous. - One member queried how auditors will consider the "compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows arising from non-financial risk" [IFRS 17 Appendix A definition of risk adjustment]. Another member responded that it is the risk of uncertainty around the insurance liability. Other items such as investment income is not considered in the determination of the IFRS 17 risk adjustment. - Overall, members supported the conclusions in AP02 and agreed that it provides appropriate flexibility at the entity level on whether to include consideration of the diversification benefits available as a result of being a part of a Group. Members agreed that articulation of the practical issues and views in the market about how the principles would be applied in practice would be helpful.	
Cash flows within the contract boundary	**AP03**
Contracts with multiple coverages - One member referred to paragraph 21 of AP03 which states that where contracts have two coverages and each coverage has different boundaries (i.e. different term to repricing), the contract boundary ends when the entity can set a price to reflect the reassessed risks of the entire contract. The member pointed out that strictly applying the staff's proposed method to an example where the boundary for one component is 5 years and the other is 7 years, would result in a long contract boundary of 35 years, which is the earliest point at which the entity will be able to reprice the contract as a whole. - Response was that consideration should be given to whether the two coverages should be accounted for as separate contracts (i.e. whether the contract should be unbundled) albeit that in this example the staff assumed that the contract is accounted for as a single contract. An alternative would be to find a sensible approximation of contract boundary. Members agreed that the substance of the contractual rights and obligations should be considered and reflected when determining the accounting treatment of contracts with multiple coverages. - Members confirmed that they had no objections to the principles in AP03. *Practical ability to reprice* - Members agreed with the conclusion that when considering an entity's practical ability to reprice, market considerations apply mostly to both existing and new contracts. - Members discussed the application of the principles to stepped premium pricing and whether different pricing practices between companies could result in different contract boundary outcomes: o One member pointed out that the wording used is "practical ability" [IFRS 17.B64] and therefore, entities should consider whether they have the ability to reprice. This differs from the choices that an entity makes (pricing decisions). [also noted in paragraph 33 of AP03] o Another member noted that there is a difference between how the business is priced and how the price is subsequently tested. Projections of future expected cash flows beyond one year may be used to test the pricing decisions applied. This could in practice mean that some entities are fully repricing for risk in one year and others smoothing this over this over a number of years. o Members agreed to reconsider this issue at a later date when views emerge from other markets. - One member noted that for some entities, the ability to fully reprice could be subject to IT system constraints and queried whether this was an issue that needs to be considered. Members responded that as this constraint would probably apply to both new and existing	

business, it is likely that it would be treated in the same way as market considerations and therefore, would not be considered a constraint on the practical ability to set a price that fully reflects risks. *Guaranteed renewability* - It was noted that this was raised as a question in the previous AASB TRG meeting [13 March 2018] and no consensus had been reached. - Members acknowledged that different views exist on the treatment of guaranteed renewability but no specific issues were raised on the content of AP03. It was therefore, agreed that this may be reconsidered at a later date if there was sufficient concern. *Options to add insurance coverage* - One member observed that this has relevance for the discussion on guaranteed renewability and noted that the ability to reprice was a key factor. Another member agreed and stated that if the terms of the renewal are specified when the contract was originally written, it is considered to be part of the original contract. - Other members noted that according to AP03, where terms of the option are not guaranteed, the entity must have the ability to reprice the whole contract in order for the option to be outside of the original contract boundary. It was observed that in most cases (depending on the option), only the option will be repriced, and the terms of the underlying contract will remain the same. One member stated that this was not clearly addressed in the flowchart in Appendix A of AP03. - Members agreed that there are currently no specific issues that need to be raised to the IASB TRG but the impact on products in the Australian market will be revisited after the May IASB TRG.	
Boundary of reinsurance contracts held with repricing mechanisms	**AP04**
- Members agreed with the conclusions in the paper. Members commented that the cedant's perspective had not been considered in the February 2018 TRG paper [AP03] and that this paper has addressed that gap. - One member noted that this could result in different contract boundaries for the same contract depending on which perspective was being considered (the cedant or the reinsurer). Other members responded that this reflects the different rights of the cedant and the reinsurer and that there are other instances where different accounting is applied in unconnected entities for the same contract. - Other members noted that this will have an impact for internal reinsurance where the reinsurer and the cedant are entities within the same consolidated group. However, in those situations, the entities will have more control over the terms of the contract that could impact the contract boundary for measurement.	
Determining the quantity of benefits for identifying coverage units	**AP05**
Insurance contracts without investment components - Members noted that the staff analysis on most of the examples agreed with the views presented at the AASB TRG in March 2018. - Members agreed with the principles based approach presented in the paper and the conclusion that the determination of coverage units is not an accounting policy choice but should be based on facts and judgment.	

- One member noted that AP05 continues to apply the concept of "standing ready". Members commented that it is to ensure that the CSM is recognised in the P&L in all periods of coverage when the insurer is "standing ready" to provide service.
- Members considered whether the entity is considered to be standing ready during the deferral period of annuities. One member noted that this can be compared with the example on Extended Warranty whereby the CSM is only earned after the original manufacturer's warranty has expired. Members agreed that an entity is only standing ready where there is an obligation to provide services. An entity cannot be considered to be standing ready during the period in which the policyholder has no ability to make valid claims.
- Members discussed the staff conclusion on Example 10 (Transaction Liability) that the insured event is the discovery of the breaches of representations and warranties and observed that the staff had drawn similarities with title insurance which indicated a possible misunderstanding of the nature of the risk coverage. One member stated that Transaction Liability was actually more akin to coverage for one day events such as concerts. Members agreed that this emphasised the importance of having a principles based approach as opposed to prescriptive guidelines to reflect the substance of the variety of products that exist in the market. The misinterpretation of the nature of the product should be raised with the IASB TRG.

Insurance contracts with investment components

- Members noted that the key question was around the interpretation of IFRS 17.BC280, specifically, whether the coverage period should be determined by reference to the insurance coverage only, or by reference to the insurance coverage and investment components.
- The paper concludes that for VFA contracts, the determination of coverage units should include investment related services. For general model contracts (non-VFA), coverage units and the coverage period (duration of coverage) are determined by reference to insurance services only i.e. excluding investment services.
- Some members queried the reason for the different treatment for VFA and non-VFA contracts. One member stated that the key difference is that under the VFA, the investment component is linked to the pool of assets. For non-VFA contracts there is an insufficient link between the investment and insurance components. Another member added that for VFA contracts, policyholders share in the profit on the investment.
- Members stated that this could be an issue for lifetime annuities with payments that are guaranteed for a period. For these contracts, the CSM will not be released until after the guarantee period as no payments or valid claims can be made during that period. Members stated that they were not aware of any other contracts in the Australian market that would be adversely impacted. Some members suggested that as the issue was restricted to a narrow part of the market, it would be useful to collaborate with insurers who write these products to work through some real examples and see if this was an issue that should be raised with the IASB TRG.
- Members discussed the IASB staff's proposal to recommend a narrow amendment to IFRS 17 to modify the definition of coverage period for VFA contracts to clarify that it includes the period in which investment services are provided. Members agreed that this indicated that the IASB were willing to make changes to the Standard where there is identifiable lack of clarity which is a good outcome. They also agreed that the change should be made but were of the view that the IASB should wait for other potential changes to emerge including the results of the EFRAG field testing before putting forward their recommendation to see if there are other issues emerging which may also necessitate changes.

Implementation challenges outreach report	**AP06**

Level of aggregation

- Members noted that the paper captured the key points raised by preparers, but noted that the paper also downplays some of the issues raised, for example, by stating that information provided by the requirement will be "less relevant" to users [AP06 paragraph 18] when submissions have noted that they would not be relevant and difficult to explain to users.
- All members agreed that the next steps recommended in the paper (education and additional disclosures) would not satisfactorily resolve the issues raised. Members stated that the solutions ignore the large cost required to create a level of presentation that is not relevant to users and difficult to explain both internally and to users.
- One member noted that the treatment of insurance assets as negative liabilities could be a potential solution.
- Another member commented that the IASB are trying to achieve the same treatment as for non-insurance entities, such as revenue on construction contracts which is accounted for on a contract by contract basis. The member also referenced AASB 101 which prohibits the offsetting of assets and liabilities unless a Standard specifically permits it. However, another member responded that a degree of offsetting is currently allowed under IFRS 17 – assets and liabilities of individual contracts within a group are currently allowed to be offset – and therefore, the issue is not about the existence of offsetting but the level at which offsetting is allowed for presentation purposes.
- Members considered whether the level of aggregation at the group level as proposed by IFRS 17 would provide useful information for analyst and Board reporting. Members stated that P&L and profitability analysis is commonly used for Board reporting. Analysis of receivables is not commonly used as a KPI for internal management reporting, but instead, analysis is performed on bad debts and financing.
- Members also noted that regulatory returns do not currently require the group level of granularity. Although the regulator has not yet determined how the returns will be amended for IFRS 17, their focus is likely to be on the risk adjustment and capital requirements which focus more on solvency.
- One member commented that presentation in the balance sheet at an entity level would appear to be a sensible solution given that all the disclosure notes are presented at an entity level. Members agreed that the point should be raised that all other presentation and disclosure requirements under IFRS 17 are at an entity level and raised the question of whether the exception for balance sheet presentation is necessary.

Treatment of contracts acquired in their settlement period

- One member highlighted paragraph 34(a) which states that "an entity applies the general model for the contracts acquired in their settlement period (because the period over which claims could develop is longer than one year) while entities expect to apply the PAA for similar contracts they issue". The member stated that a point should be raised to clarify that a contract with coverage period of more than a year may still qualify for the PAA if the eligibility criteria is met (the measurement of the LfRC applying the PAA would not differ materially from the LfRC that would be produced when applying the general model [IFRS 17.53(a)]).
- Consistent with the view expressed at the previous AASB TRG (March 2018), members acknowledged that the measurement principles applied under IFRS 17 are similar to the recognition of revenue by different entities within a value chain.
- Members agreed that there were no other issues to be raised on the treatment of contracts acquired in their settlement period but note was made of the practical difficulties implementing this for portfolios under PAA where the acquired portfolio would be measured under the general model if PAA eligibility was not met.

Reporting on other questions submitted	**AP07**

- Members considered all the submissions in AP07. No issues were raised on any of the submissions and conclusions presented in the paper.

Closing remarks

- Members were asked for their views on the top issues for the Australian market.
- Members responded that these are:
    - Level of aggregation for balance sheet presentation;
    - Use of premiums received when applying the PAA; and
    - Reinsurance.
- Members noted that other issues may emerge as preparers progress through implementation given many were in early stages or had not started.

Actions

- AP01: Draft paper on treatment of investment linked insurance contracts where they are separate contracts
- AP05: Identify insurers who write lifetime annuity products with payments that are guaranteed for a period to work through the impacts of the clarification of BC280 for these contracts

End Meeting