IFRS Transition Resource Group for IFRS 17 *Insurance Contracts* (TRG)

Submission form for potential implementation question

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Potential Implementation Question

This paper considers four questions where the interpretation of IFRS 17 appears to be unclear with respect to certain principles in paragraphs 34(b) and B64. The purpose of this paper is to seek further clarification from the IASB of these principles.

The four interpretive questions are:

1) What is meant by "risks" (of the particular policyholder) in the context of paragraph 34(b)?

2) Are commercial considerations relevant when considering the "practical ability to reassess….and set a price or level of benefits that fully reflects the risks of that portfolio" in paragraph 34(b)(i)?

3) Paragraph 34(b)(ii), states that "pricing that…does not take into account the risks that relate to the period after the reassessment date". Assuming the pricing structure is presented in a way which aligns to risks only up to the reassessment date, is it relevant that the entity may take a long term view of risk when setting that pricing structure?

4) Under IFRS 17 paragraph 34, does guaranteed renewability represent a substantive right or obligation to the entity?

The four questions are relevant for insurers in assessing the contract boundary for products with certain features which are discussed in the paper. The contract boundary assessment is, in turn, relevant for the following key reasons:

- It affects whether the product in question may be eligible for the simplified measurement approach ('premium allocation approach'); and
- It affects which cash flows should be included in the measurement of the liability for remaining coverage.

We are concerned that, without clarification on these principles from the IASB, IFRS 17 may not be consistently applied in practice when assessing the contract boundary which may lead to diversity. This question is expected to be relevant for a wide range of Australian insurance contracts, as indicated by the examples within this paper. Further, we understand that the features of the Australian insurance contracts set out in the examples within this paper are not unique to Australia and that the questions set out in this paper are relevant to a wide range of life insurance, general insurance and health insurance contracts globally.

The remainder of this Paper is structured as follows:

- Extracts from IFRS 17 I*nsurance Contracts*
- Analysis of the questions
  - Introduction
  - Key interpretive questions (including potential alternative interpretations)
- Examples of application to certain Australian life, health and general insurance contracts (illustrative products have been selected with common features)
- Summary of conclusions
- Appendix – Relevant references to "practical ability" in International Financial Reporting Standards

Extracts from IFRS 17 Insurance Contracts

Paragraph 34(b), which relates to the assessment of contract boundaries where the pricing of risks applies to a portfolio of insurance contracts.

IFRS17.34

"Cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity can compel the policyholder to pay the premiums or in which the entity has a substantive obligation to provide the policyholder with services (see paragraphs B61–B71). A substantive obligation to provide services ends when:

…

(b) both of the following criteria are satisfied:

(i) the entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio; and

(ii) the pricing of the premiums for coverage up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date."

IFRS17.B64

"Paragraph 34 refers to an entity's practical ability to set a price at a future date (a renewal date) that fully reflects the risks in the contract from that date. An entity has that practical ability in the absence of constraints that prevent the entity from setting the same price it would for a new contract with the same characteristics as the existing contract issued on that date, or if it can amend the benefits to be consistent with the price it will charge. Similarly, an entity has that practical ability to set a price when it can reprice an existing contract so that the price reflects overall changes in the risks in a portfolio of insurance contracts, even if the price set for each individual policyholder does not reflect the change in risk for that specific policyholder. When assessing whether the entity has the practical ability to set a price that fully reflects the risks in the contract or portfolio, it shall consider all the risks that it would consider when underwriting equivalent contracts on the renewal date for the remaining coverage. In determining the estimates of future cash flows at the end of a reporting period, an entity shall reassess the boundary of an insurance contract to include the effect of changes in circumstances on the entity's substantive rights and obligations."

Introduction

At the IASB's TRG meeting on 6 February 2018, paper AP02 discussed the boundary of contracts with annual repricing mechanisms. The first example in that paper is understood to be based on an Australian stepped premium yearly renewable term (YRT) style contract with an annual repricing mechanism.

This paper summarises the key questions that we believe remain open to interpretation. Four interpretive questions are discussed and these are in turn applied to illustrative fact patterns for life insurance, general insurance and health insurance contracts in Australia under IFRS 17.

This submission was considered at the March 2018 meeting of the Australian Accounting Standards Board's (AASB's) Transition Resource Group for AASB 17 *Insurance Contracts* meeting. The views of members are reflected throughout this paper. Members include insurance specialist from a range of industries, backgrounds and product types.

This paper:

- Only considers examples that are assessed under the criteria set out in paragraph 34(b) of IFRS 17, which states that the insurer's substantive obligation to provide services ends when both of the following criteria are satisfied:
  - *i) the entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio; and*
  - *ii) the pricing of the premiums for coverage up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date.*
- Does not consider examples assessed under the criteria set out in paragraph 34(a) of IFRS 17 – i.e. risks are reassessed and a price is set for an individual policyholder; and
- Does not consider the impact of regulatory pricing constraints on the contract boundary. i.e. it is assumed that any regulatory requirements do not constrain the entity's pricing; and
- Does not consider the impact of industry equalisation schemes on pricing or contract boundary.

Key Interpretative Questions

1. *What is meant by "risks" (of the particular policyholder) in the context of paragraph 34(b)?*	
View A – "risks" refers only to those insurance and financial risks transferred from the policyholder to the entity[1]. It does not refer to broader risks to which the entity is exposed, such as lapse or expense risk.	**View B** – "risks" refers to all risks, including other risks that the entity takes on in writing the business, irrespective if the risks may directly cause a loss to the policyholder.
View A supported by: - The IASB staff clarified in paper AP02 paragraph 18 of the 6 February 2018 TRG meeting and during the TRG discussions that only policyholder risks were meant to be considered. We further note that paragraph 34 (b) should be read as an extension of the risk reassessment from individual to portfolio level, without extending policyholder risks to all types of risks and considerations applied by an entity when pricing a contract. - Paragraph B64 refers to the entity considering "all the risks that it would consider when underwriting equivalent contracts on the renewal date for the remaining coverage". A narrow view of the meaning of "underwriting" would imply only the risks that are assessed as part of the policyholder underwriting process, this would then exclude risks to which the entity is exposed, such as lapse and expense risk.	**View B supported by:** - Paragraph B64 refers to the entity considering "all the risks that it would consider when underwriting equivalent contracts on the renewal date for the remaining coverage". A broader view of the meaning of "underwriting" would imply all risks would be considered in pricing, including risks to which the entity is exposed, such as lapse and expense risk. Because these risks are passed on to the policyholder, they could also be seen as policyholder risks.
On balance, the AASB 17 TRG broadly supported interpretation in accordance with view A but further clarification of paper AP02 is requested from the IASB.	

A further question arises as to whether the policyholder is itself exposed to lapse risk through its choice of payment method to an intermediary used to facilitate the purchase. If the policyholder pays a fee to the intermediary then it cannot recover that fee upon cancellation of the policy. Alternatively the policyholder can transfer that risk to the insurer by purchasing a policy that pays an upfront commission to the intermediary in return for a higher premium. A distinction between this and other risks to the policyholder (such as insurance risk and financial risk) is that this is a cost that only arises as a result of the decision to purchase the policy. This question was discussed by the AASB TRG, with wide support that lapse risk characterised in this way is not part of policyholder risk for the purpose of assessing the requirements of paragraph 34(b).

[1] Examples of financial risk transferred from the policyholder to the entity could be investment components or guarantees provided by the entity that transfers the risk of adverse investment market developments from the policyholder to the entity.

<table>
<tr><td colspan="2">2. Are commercial considerations relevant when considering the “practical ability to reassess….and set a price or level of benefits that fully reflects the risks of that portfolio” in paragraph 34(b)(i)?</td></tr>
<tr><td colspan="2">Extracts from IFRS 17 paragraph B64:
“…An entity has that practical ability in the absence of constraints that prevent the entity from setting the same price it would for a new contract with the same characteristics as the existing contract issued on that date, or if it can amend the benefits to be consistent with the price it will charge (”Extract 1”) … an entity has that practical ability to set a price when it can reprice an existing contract so that the price reflects overall changes in the risks in a portfolio of insurance contracts, even if the price set for each individual policyholder does not reflect the change in risk for that specific policyholder (“Extract 2”) …”</td></tr>
<tr><td>View A – No.</td><td>View B – Yes.</td></tr>
<tr><td>View A supported by:
- Extract 1 could be interpreted to imply that, if the entity can set the same price for the existing policyholder as it can for a new policyholder, then it has the practical ability to reprice. Market pressures to remain competitive are likely to apply to new business as well as to existing business and so the entity’s practical ability to reprice is not constrained.
- Extract 2 extends this to the portfolio level. In practice, commercial factors may restrict an entity’s ability to reprice certain segments of business within the portfolio to fully reflect the risks. However, the pricing will typically offset these through cross-subsidising other segments within the portfolio. Therefore, for the portfolio, the entity’s ability to reprice is not practically constrained.</td><td>View B supported by:
- The points noted in support of view A in respect of Extract 1 from para B64 would not apply if substandard risks within the portfolio could not be fully repriced to reflect their risk as a result of market pressures. If the equivalent new contract on the same (substandard) risk is priced higher than the existing contract then this could represent a practical constraint on the entity.
- This view ignores the significance of Extract 2 which extends Extract 1 to the portfolio level.</td></tr>
<tr><td colspan="2">The AASB 17 TRG expressed mixed views on this question. Further clarification of this matter would be useful.

It was noted that entities may have different approaches to pricing and the application of commercial considerations, which may result in different outcomes across different entities when applying the principles set out in this question.</td></tr>
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The Appendix to this paper provides extracts from the IASB’s Draft Conceptual Framework (“the ED”) and other IFRSs that make reference to “practical constraints” or a “practical ability”. The ED notes that “economic compulsion may be a factor that reduces an entity’s practical ability to avoid…”. This implies that some consideration of the economic consequences of a particular course of action (for example a commercial repricing exercise) may be relevant when assessing the entity’s “practical ability” to take that action.

3. *Paragraph 34(b)(ii), states that "pricing that…does not take into account the risks that relate to the period after the reassessment date". Assuming the pricing structure is presented in a way which aligns to risks only up to the reassessment date, is it relevant that the entity may take a long term view of risk when setting that pricing structure?*	
View A – yes. This information is relevant and "pricing" incorporates all aspects of how the portfolio is priced, including consideration *of long term cash flow projections* that may allow for risks relating to periods after the reassessment date even though, prima facie, the pricing structure (e.g. a table of premium rates disclosed to the policyholder) aligns to risks only up to the reassessment date.	**View B** – no. This information is not relevant and "pricing" only reflects the way in which the pricing structure is presented (e.g. a table of premium rates disclosed to the policyholder), which presented in a way that aligns to risks only up to the reassessment date. It is assumed that this structure broadly reflects the risk profile of the portfolio (though in practice it may not exactly mirror the portfolio risk as noted in view A).
View A supported by: - IASB TRG paper AP02 paragraph 20 and BC 162(a) note that "an entity may price a contract so that the premiums charged in early years subsidise the premiums charged in later periods, even if the contract states that each premium relates to an equivalent period of coverage". - This can be interpreted to imply that any practical pricing cross-subsidisation across periods should be considered, irrespective of whether the premium rate structure states that premium's rate to a particular period of coverage. - The February IASB TRG summary also references circumstances where "some entities use a step-rated premium table for pricing that averages out the pricing between the different levels on the table (ie between the different steps)", which was described during the meeting as "smoothing".	**View B supported by:** - IASB TRG paper AP02 paragraph 21 implies that, for the YRT example, the entity uses "step rated tables" reflecting the risks that result from the actual age of the policyholder. - Notwithstanding the comments from IASB TRG paper AP02 paragraph 20 and BC162(a) (noted within view A), these extracts go on to note that *"this would be the case if the contract charges level premiums and the risks covered by the contract increase with time"* and therefore appear to be referring to the level premium example, not the stepped premium example, indicating that any cross subsidisation across time periods must be significant or material in order to fail the criteria in 34(b)(ii).
	The AASB 17 TRG broadly supported interpretation in accordance with view B. It was noted that entities may have different approaches to pricing which may result in different resulting outcomes across different entities when applying the principles set out in this question.

4. *Under IFRS 17 paragraph 34, does guaranteed renewability represent a substantive right or obligation to the entity?*		
View A – Yes	**View B** – No	**View C -** Yes, if underwriting is performed on the policyholder at inception, otherwise no
View A supported by: - A portfolio of contracts may contain substandard risks for whom the ability to renew their contracts at the standard price has value. The entity may not be able to fully reprice the portfolio to reflect these risks, which represents a substantive obligation to the entity. In this case, the premiums charged for the renewing portfolio differ to those for a newly incepted portfolio of equivalent risks and paragraph B64 implies that a substantive obligation exists. - The IASB TRG summary and discussion indicates that if the entity instead has a practical ability to reassess risks only at a general level (for example, for a general community) and, as a result, can set a price for the portfolio of insurance contracts that contains the contract (for example, using a generic step-rate table) then this would result in a substantive obligation to the entity.	**View B supported by:** - A portfolio of contracts may contain substandard risks for whom the ability to renew their contracts at the standard price has value. If the entity is able to fully reprice the portfolio to which these contracts belong then it can fully reflect the substandard risks existing within the portfolio. The premiums charged for the renewing portfolio would be the same as those for a newly incepted portfolio of equivalent risks and paragraph B64 implies that a substantive obligation does not exist. - In other words there is value to the now substandard policyholder but as it would be anticipated by the insurer that there would be a certain percentage of substandard risks then the entity has already recognised a sufficient obligation.	**View C supported by:** - For the underwritten contracts, insurers can decline new policyholders, there would be a substantive obligation because a policyholder that is a substandard risk could be declined when attempting to switch to another insurer even though the pricing would be subject to the same cap when accepted. In other words, there would be a specific incentive for the policyholder to continue or renew its contract because it might not receive cover from another insurer. - For the non-underwritten contracts, insurers cannot decline any policyholders, there would be no substantive obligation because the restrictions would not affect the policyholder at all when it wants to switch to another insurer. In other words, there would be no specific incentive for the policyholder to continue or renew its contract because it would get comparable conditions when entering into a contract with the same cover with another insurer.
The AASB 17 TRG expressed mixed views on this question. Further clarification of this matter would be useful.		

Examples of application to certain Australian life, health and general insurance contracts

The following examples consider the ***possible*** contract boundary outcome if each of the alternative interpretations above are applied.

Example 1: Stepped premium yearly renewable term life insurance

Features

- Insured lives only are subject to individual underwriting at contract inception and each insured is assigned a risk ranking that never is changed if the contract is continuously renewed.
- The specific price for an individual purchasing insurance is based on the insured's age and gender (and potentially other factors, such as occupation) with any loadings on the base premium, or exclusions, set by reference to their individual circumstances and underwriting results.
- In practice, insurers' pricing is based on risks to which they are exposed within the portfolio which may include policyholders' deteriorating health, selective lapsation etc.
- Many contracts have significant upfront acquisition costs which the insurer aims to recover over the expected life of the contract, or in some cases clawback mechanisms for commissions if the policyholder lapses early in the contract's expected life (e.g. before 13 months or 2 years).
- Policies may be automatically renewed at the option of the policyholder each anniversary, and the insurer has no right to underwrite, refuse cover or change their individual loadings or exclusions.
- Subsequent premium prices are set by reference to a stepped premium rate table based on the insured's age and increase each policy renewal date accordingly (e.g. all insured lives aged 42 have the same base premium with loadings based on their initial underwriting).
- The premium increase in the table from one year to the next is not necessarily a fixed amount or percentage, but generally varies according to age.
- The insurer is permitted to update the stepped premium rate table at any time, and will regularly update the table to reflect experience and risk in the overall portfolio and at individual ages. The updated table will apply to both new and in-force policies across the portfolio.

Analysis of Example 1: Stepped premium yearly renewable term life insurance

What is meant by "risks" (of the particular policyholder) in the context of paragraph 34(b)?	
View A – The stepped premium rate table shows that the rates increase with age suggesting no cross-subsidisation beyond the contract boundary. Lapse and expense risk are considered entity risk only. Therefore pricing does not allow for risks beyond the next renewal date, 34(b)(ii) is satisfied and ***the contract boundary is 1 year.***	**View B** – Allowance for lapse and expense risk is incorporated into pricing over the expected life of the policies (e.g. through the recoupment of upfront acquisition costs via renewal premiums). Therefore pricing allows for risks beyond the next renewal date, 34(b)(ii) is not satisfied and ***the contract boundary is greater than 1 year.***

Are commercial considerations relevant when considering the "practical ability to reassess….and set a price or level of benefits that fully reflects the risks of that portfolio" in paragraph 34(b)(i)?	
View A – The repricing terms mean that the entity has the practical ability to reprice to fully reflect the risks of the portfolio and ***the contract boundary is 1 year.***	**View B –** Market forces result in a practical constraint on the pricing of some segments and individuals which are under or overpriced relative to the risk and ***the contract boundary is greater than one year.***

Paragraph 34(b)(ii), states that "pricing that…does not take into account the risks that relate to the period after the reassessment date". Assuming the pricing structure is presented in a way which aligns to risks only up to the reassessment date, is it relevant that the entity may take a long term view of risk when setting that pricing structure?	
View A – Commercial aspects of pricing are likely to result in cross-subsidies across coverage periods, for example: - Cross-subsidies in pricing between different rating factors such as age or gender. - Cross-subsidisation over time, due to selection and anti-selection effects may result in the risk profile for new policyholders differing from the risk profile of in-force / renewing policyholders. - The application of bundling or loyalty discounts resulting in the premium charged to new policyholders differing from the risk profile of renewing policyholders. Therefore pricing allows for risks beyond the next renewal date, 34(b)(ii) is not satisfied and ***the contract boundary is greater than 1 year.***	**View B –** The stepped nature of the premium rate table suggests that pricing reflects the risk for the current coverage period only, i.e. premium rates increase with age to reflect the risk in future periods. Therefore pricing does not allow for risks beyond the next renewal date, 34(b)(ii) is satisfied and ***the contract boundary is 1 year.***

Under IFRS 17 paragraph 34, does guaranteed renewability represent a substantive right or obligation to the entity?		
View A – The policyholder has the right to renew the policy and continue their coverage. Therefore ***the contract boundary is greater than 1 year.***	**View B –** The entity can reprice to fully reflect the risks of the portfolio. Therefore ***the contract boundary is 1 year.***	**View C –** The policyholder has the right to renew the policy and continue their coverage and was fully underwritten when they took out the contract. Because life insurers can decline new policyholders or add loadings to the premium to reflect policyholder risks at the time of inception of the contract, there is a substantive obligation arising from guaranteed renewability because there is an incentive for a renewing policyholder in poor health to continue or renew its contract because they may not be able to

		get comparable terms and conditions when entering into a new contract with the same or similar cover with the same or another insurer. Therefore ***the contract boundary is greater than 1 year.***

Example 2: Australian private health insurance

Features

- Insurers in the market are not permitted to underwrite or refuse coverage of insured lives
- Insurers may have upfront acquisitions costs, including in some cases commissions, which the insurer will aim to recover over the expected life of the contract.
- Prices are regulated such that the insurer is only allowed to set one base premium rate for each type and level of insurance coverage. This "community rated" price may not be varied for age, medical condition or other pre-existing factors.
- The community rated price applies equally to both new and renewing policyholders who have held private health insurance continuously (with any insurer or insurers) since they were 30.
- Regulatory loadings are applied if policyholders did not continuously hold insurance since they were age 30, depending on the amount of time they didn't hold insurance and their age.
- Insurers may change their prices with six weeks' notice to the regulator. In practice the majority of insurers update their prices on 1 April each year.
- Many insurers allow policyholders to pay premiums up to a year in advance, in which case they are not subject to any premium increases until their next premium payment is due.
- When insurers change their prices they will reflect the experience/ risk in the portfolio to which the price will apply.
- Waiting periods may apply to new policyholders for certain benefits.

Analysis of Example 2: Australian Private Health Insurance

What is meant by "risks" (of the particular policyholder) in the context of paragraph 34(b)?	
View A – Health insurance contracts may be repriced with six weeks' notice, although in many cases repricing occurs annually on 1 April. This repricing fully reflects expected claim costs based on the underlying risk profile of the policyholders within the portfolio and does not consider claim costs beyond the next annual repricing cycle. Therefore pricing does not allow for risks beyond the next annual repricing date, 34(b)(ii) is satisfied and ***the contract boundary is 1 year.***	**View B** – Allowance for lapse and expense risk may be incorporated into pricing beyond the first renewal date. (e.g. through the recoupment of upfront acquisition costs eg iSelect via renewal premiums). Therefore pricing allows for risks beyond the next renewal date, 34(b)(ii) is not satisfied and ***the contract boundary is greater than 1 year.***

Are commercial considerations relevant when considering the "practical ability to reassess….and set a price or level of benefits that fully reflects the risks of that portfolio" in paragraph 34(b)(i)?	
View A – The entity has the practical ability to set prices to fully reflect the risk of the portfolio through its annual rate reassessment and ***the contract boundary is 1 year.***	**View B –** The entity's annual rate reassessment is constrained by market forces resulting in some segments and individuals being under or overpriced relative to the risk and ***the contract boundary is greater than one year.***

Paragraph 34(b)(ii), states that "pricing that…does not take into account the risks that relate to the period after the reassessment date". Assuming the pricing structure is presented in a way which aligns to risks only up to the reassessment date, is it relevant that the entity may take a long term view of risk when setting that pricing structure?	
View A – The community rated nature of health insurance means that there is implicit cross-subsidies over coverage periods. Examples include: - Differential premiums charged to policyholders depending on the age at which they first took out health cover. - Cross-subsidisation over time, due to selection and anti-selection effects may result in the risk profile for new policyholders differing from the risk profile of in-force / renewing policyholders. Therefore pricing allows for risks beyond the next renewal date, 34(b)(ii) is not satisfied and ***the contract boundary is greater than 1 year.***	**View B –** Health insurance contracts are repriced annually effective 1 April. This annual rate reassessment fully reflects expected claim costs based on the underlying risk profile of the policyholders within the portfolio and does not consider claim costs beyond the next annual repricing cycle. Therefore pricing does not allow for risks beyond the next renewal date, 34(b)(ii) is satisfied and ***the contract boundary is 1 year.***

Under IFRS 17 paragraph 34, does guaranteed renewability represent a substantive right or obligation to the entity?		
View A – The policyholder has the right to renew the policy and continue their coverage. Therefore ***the contract boundary is greater than 1 year.***	**View B –** The entity can reprice to fully reflect the risks of the portfolio. Therefore ***the contract boundary is 1 year.***	**View C –** Because insurers in the health insurance market cannot decline any policyholders or vary the premium to reflect the policyholder risk at inception of the contract, there would be no substantive obligation arising from guaranteed renewability because there would be no specific incentive for the policyholder to continue or renew its contract because they would get comparable conditions when entering into a contract with the same or similar cover with another insurer. Therefore ***the contract boundary is 1 year.***

Example 3: Compulsory Third Party (CTP) Insurance

Features of an example scheme

- This is compulsory insurance for all motor vehicles, which insures against liability for any death or injury to other road users caused by the vehicle regardless of who is driving.
- Insurers in the market are not permitted to underwrite or refuse coverage
- Insurers may have upfront acquisition costs, including in some cases commissions, which the insurer will aim to recover over the expected life of the contract.
- Prices are regulated such that the insurer is only allowed to set one premium rate according to the vehicle classification (eg motor car vs bus) and geographic region. This "community rated" price may not be varied for individual driving history or other individual factors.
- The community rated price applies equally to both new and renewing policyholders.
- The government authority issues Premiums Determination Guidelines as a mechanism to regulate the setting of prices.
- When setting premium rates insurers generally will have regard to their experience and the costs/ risks they anticipate in their portfolio in the coming year.
- Insurers are required to submit premium filings to the government authority at least annually (and voluntarily at any time during the year), setting out proposed premiums and additional information in support of those premiums. The government authority may reject proposed premiums if it believes the proposal means insurers will not have sufficient premium income to meet their liabilities and to also make a reasonable, but not excessive, profit.

Analysis of Example 3: Compulsory Third Part (CTP) Insurance

What is meant by "risks" (of the particular policyholder) in the context of paragraph 34(b)?	
View A – CTP premiums are permitted to be repriced at any time during the year, and are reviewed at least annually. This fully reflects expected claim costs based on the underlying risk profile of the policyholders within the repricing portfolio and does not consider claim costs beyond the next annual repricing cycle. Therefore pricing does not allow for risks beyond the next annual repricing date, para 34(b)(ii) is satisfied and ***the contract boundary is 1 year.***	**View B** – Upfront acquisition costs are generally not significant for CTP and would be expected to be incorporated into the current year's pricing. Therefore pricing generally only allows for risks up to the next renewal date, para 34(b)(ii) is satisfied and ***the contract boundary is 1 year.***

Are commercial considerations relevant when considering the "practical ability to reassess….and set a price or level of benefits that fully reflects the risks of that portfolio" in paragraph 34(b)(i)?	
View A – The entity has the practical ability to set prices to fully reflect the risk of the portfolio through regular rate reassessment and ***the contract boundary is 1 year.***	**View B –** The entity's regular rate reassessment is constrained by market forces resulting in some segments and individuals being under or overpriced relative to the risk and ***the contract boundary is greater than one year.***

Paragraph 34(b)(ii), states that "pricing that…does not take into account the risks that relate to the period after the reassessment date". Assuming the pricing structure is presented in a way which aligns to risks only up to the reassessment date, is it relevant that the entity may take a long term view of risk when setting that pricing structure?	
View A – The community rated nature of CTP means that there could be implicit cross-subsidies over coverage periods. Examples of cross subsidies identified include: - Cross-subsidies in pricing between different ages or genders – unlikely to be across coverage periods. - The application of loyalty discounts resulting in the premium charged to new policyholders differing from the risk profile of renewing policyholders – potentially across coverage periods. Only where cross subsidies occurs across coverage periods would pricing allow for risks beyond the next renewal date, therefore, para 34(b)(ii) is not satisfied and ***the contract boundary is greater than 1 year.***	**View B –** CTP policies are repriced annually by the entity. This repricing fully reflects expected experience based on the underlying risk profile of the policyholders within the portfolio and does not consider claim costs beyond the next annual repricing cycle. There can be some overall guidance from the government on the average premium to be applied for the next period, but in general, insurers are able to freely set premiums within the specified bands for each class and relativities between classes, subject to being able to justify that their premiums reflect expected claims and permitted expense assumptions to generate a reasonable but not excessive (or insufficient) profit at an annual portfolio level. Some pricing proposals prepared do not consider claims cost beyond the next annual repricing cycle. Therefore pricing does not allow for risks beyond the next renewal date, para 34(b)(ii) is satisfied and the ***contract boundary is 1 year***.

Under IFRS 17 paragraph 34, does guaranteed renewability represent a substantive right or obligation to the entity?		
View A – The policyholder has the right to renew the policy and continue their coverage. Therefore ***the contract boundary is greater than 1 year.***	**View B –** The entity can reprice to fully reflect the risks of the portfolio. Therefore ***the contract boundary is 1 year.***	**View C –** Because insurers in the CTP market cannot decline any policyholders, there would be no substantive obligation arising from guaranteed renewability because there would be no specific incentive for the policyholder to continue or renew its contract because they would get comparable conditions when entering into a contract with the same or similar cover with another insurer. ***Therefore the contract boundary is 1 year.***

Summary of analysis:

The ***possible*** contract boundary outcome if each of the alternative interpretations above are applied is summarised as follows:

1. *What is meant by "risks" (of the particular policyholder) in the context of paragraph 34(b)?*

- If view A is taken then the contract boundary for stepped YRT, Australian health insurance and NSW CTP are **all 1 year**.
- If view B is taken then:
    - The contract boundary for stepped YRT and Australian health insurance are **greater than 1 year** and
    - The contract boundary for CTP is **1 year.**

On balance, the AASB 17 TRG broadly supported interpretation in accordance with view A but further clarification of paper AP02 is requested from the IASB.

2. *Are commercial considerations relevant when considering the "practical ability to reassess….and set a price or level of benefits that fully reflects the risks of that portfolio" in paragraph 34(b)(i)?*

- If view A is taken then the contract boundary for stepped YRT, Australian health insurance and NSW CTP are **all 1 year**.
- If view B is taken then the contract boundary for stepped YRT, Australian health insurance and NSW CTP are **all greater than 1 year**.

The AASB 17 TRG expressed mixed views on this question. Further clarification of this matter would be useful.

3. *Paragraph 34(b)(ii), states that "pricing that…does not take into account the risks that relate to the period after the reassessment date". Assuming the pricing structure is presented in a way which aligns to risks only up to the reassessment date, is it relevant that the entity may take a long term view of risk when setting that pricing structure?*

- If view A is taken then the contract boundary for stepped YRT, Australian health insurance and NSW CTP are **all 1 greater than 1 year**.
- If view B is taken then the contract boundary for stepped YRT, Australian health insurance and NSW CTP are **all 1 year**.

The AASB 17 TRG broadly supported interpretation in accordance with view B.

4. *Under IFRS 17 paragraph 34, does guaranteed renewability represent a substantive right or obligation to the entity?*

- If view A is taken then the contract boundary for stepped YRT, Australian health insurance and NSW CTP are all **1 year**.
- If view B is taken then the contract boundary for stepped YRT, Australian health insurance and NSW CTP are all **greater than 1 year**.
- If view C is taken then:
    - The contract boundary for stepped YRT **is greater than 1 year**, and
    - The contract boundary for Australian health insurance and NSW CTP are **1 year.**

The AASB 17 TRG expressed mixed views on this question. Further clarification of this matter would be useful.

Appendix - Relevant references to "practical ability" in International Financial Reporting Standards

- **IFRS 16 *Leases*:**

  Substantive substitution rights

  - IFRS 16.B14: "…A supplier's right to substitute an asset is substantive only if both of the following conditions exist:

    (a) the supplier has the **practical ability** to substitute alternative assets throughout the period of use… ; and

    (b) the supplier would benefit economically from the exercise of its right to substitute the asset"

    Comment by the AASB 17 TRG: The standard separates the economic consideration from consideration of the "practical ability".

- **IFRS 10 *Consolidated Financial Statements*:**

  Substantive rights

  - IFRS 10.B22: "…For a right to be substantive, the holder must have the practical ability to exercise that right."

  - IFRS 10.B23: "Determining whether rights are substantive requires judgement, taking into account all facts and circumstances. Factors to consider in making that determination include but are not limited to:

    (a) Whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights. Examples of such barriers include but are not limited to:

      (i) financial penalties and incentives that would prevent (or deter) the holder from exercising its rights.

      (ii) an exercise or conversion price that creates a financial barrier that would prevent (or deter) the holder from exercising its rights…

    …"

    Comment by the AASB 17 TRG: Specific reference to economic considerations in terms of practical ability to exercise the right.

- **IFRS 9 *Financial Instruments*:**

  Evaluation of the transfer of control

  - IFRS 9.B3.2.8: "The transferee has the practical ability to sell the transferred asset only if the transferee can sell the transferred asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer. The critical question is what the transferee is able to do in practice, not what contractual rights the transferee has concerning what it can do with the transferred asset or what contractual prohibitions exist. In particular:

(a) a contractual right to dispose of the transferred asset has little practical effect if there is no market for the transferred asset, and

…"

- **IASB Exposure Draft *Conceptual Framework for Financial Reporting*:**

Definition of a liability

- Paragraph 4.31: "An entity has a present obligation to transfer an economic resource if both:

  a) the entity has no practical ability to avoid the transfer

  …"

- Paragraph 4.32: "An entity has no practical ability to avoid if, for example, the transfer is legally enforceable, or any action necessary to avoid the transfer would cause significant business disruption or would have economic consequences significantly more adverse than the transfer itself …"

- Paragraph BC4.71: "…the IASB proposes the term 'no practical ability to avoid', because it thinks that it most effectively conveys the need to identify what the entity is able to do, instead of what the probable outcome will be…"

- Paragraph BC4.72: "Many respondents asked for guidance on the meaning of 'no practical ability to avoid'. The IASB acknowledges that applying the concept will require judgement. The IASB will, if necessary, develop guidance on applying that concept to particular cases as it develops specific Standards."

- Paragraph BC4.75:
  The IASB thinks that these criteria make it clear that:
  (a) "economic compulsion may be a factor that reduces the entity's practical ability to avoid a future transfer–so it would need to be considered in assessing whether that criterion is met; but
  …"

END