Australian Government
Australian Accounting Standards Board

TRG Minutes

Meeting information

AASB 17 *Insurance Contracts* Transition Resource Group (TRG)
13 July 2018
3.00pm-5.00pm AEST

Objective: To discuss and provide feedback on the proposed submissions to the IASB on risk adjustment and the treatment of reinsurance held. Members were also asked to provide feedback on whether the submissions should be forwarded to the IASB.

ATTENDANCE	ORGANISATION
Anne Driver (Chair) (via teleconference)	QBE
Stuart Alexander	Deloitte
Stephen Burton (via teleconference)	Suncorp
Brendan Counsell	EY
Tom Exton (via teleconference)	Medibank
Peter Grant	Insurance Australia Group (IAG)
Scott Hadfield (via teleconference)	PwC/AALC
Chris Maher	AMP
Ian Moyser	KPMG
Kris Peach (via teleconference)	AASB
Rachel Poo	QBE/Deloitte
James Barden (via teleconference)	AASB Staff
Grant Robinson	AMP/ Institute of Actuaries IFRS 17 Implementation Task Force
David Rush	Institute of Actuaries IFRS 17 Implementation Task Force
Weldon Luo (via teleconference)	ATO (on behalf of Frank Saliba)
Rob Sharma	APRA
Ayman Sobhan	Insurance Council of Australia
Michael Sokulski (via teleconference)	Medibank
Angus Thomson (via teleconference)	QBE
Tony Tong	Pacific Life Re
Jeroen Van Koert (via teleconference)	AIA

Topic	Agenda paper
Measurement of the risk adjustment	**AP01**

- Preparers introduced the paper and provided a summary of the key issues being raised:
    - The paper was prepared by a working group of the AASB TRG and has been discussed at the Accountants and Actuaries Liaison Committee (AALC) where there was broad agreement on the content of the paper. Feedback received from the AALC has been reflected in the draft paper being discussed (AP01).
    - The issue around risk adjustment has arisen as a result of the discussions at the IASB May 2018 TRG (AP02 of the IASB May 2018 TRG meeting) where the IASB staff expressed the view that IFRS 17.B87 is interpreted to mean that risk adjustment is defined at the time the premium is charged. This implies that a single decision about risk adjustments is made by the issuing insurer; and therefore, the risk adjustment at a Group level must be the addition of subsidiary risk adjustments. The diversification benefits available at the Group may or may not be 'pushed down' from the Group level to the subsidiary entity level.
    - It is not clear from AP02 of the IASB May 2018 TRG whether this single decision around the determination of the risk adjustment is made once and not subsequently revisited. The conclusion from the IASB May 2018 TRG seems to be inconsistent with the principle that the risk adjustment is the compensation the entity would require at the reporting date to make it indifferent between fulfilling a liability that has a range of possible outcomes and fulfilling a liability that will generate fixed cash flows.

Initial recognition vs subsequent measurement considerations

- One member observed that the IASB seemed to be focused on the concept of "charged", which is technical pricing at the issue of the contract, and therefore consider that there can only be one view of the risk adjustment. There wasn't sufficient consideration of determination of the risk adjustment in relation to claims liabilities.
- A member asked for more clarity around the question asked in the paper, specifically, whether the question is just about the determination of risk adjustment at inception of the contracts or whether it also included subsequent measurement considerations.
    - Other members confirmed that the paper included consideration of both although they acknowledged that some of the comments made in the IASB May 2018 TRG meeting had significant implications for subsequent measurement that might not have been adequately considered.
- A few members agreed that the primary issue the paper should address is whether the risk adjustment at the Group level needs to be the addition of the risk adjustments at the subsidiary level.

Should the risk adjustment at the Group level be the addition of the subsidiary risk adjustments?

- Members commented that the potential inability of the entity to consider a Group view of risk adjustment may result in a lack of ability to compare Groups of companies.
- One member expressed the view that the IASB staff conclusions at the IASB May 2018 TRG provides practical benefits, particularly where the general model and variable fee approach (VFA) are applied, as entities would not be required to hold two sets of information to reflect the risk adjustments at the subsidiary and Group levels respectively.
    - One member asked if it is possible to have different CSMs at the subsidiary and the Group level. Members considered that it is possible to have different CSMs and

possibly different liability measurement at the subsidiary and the Group, for example, due to different expense structures or level of aggregation.

  - Members agreed that few entities would want to have different sets of information for subsidiary and Group reporting. Consequently, there would be a natural desire to have a common view of the CSM or risk adjustment, but it should not be forced. It would not always be appropriate to require local Boards to take the Group's view of risk due to local risk appetites or other (e.g. regulatory) factors and local Boards should be allowed to retain their independence.
  - It was also noted that prior to the conclusions of the IASB May 2018 TRG, the Standard appeared to be written such that an entity could consider the entity specific view separately from the Group view.

- Another member expressed the view that the IASB was trying to reach a conclusion that would be helpful to preparers by allowing the entity to reflect the entity specific risk adjustment or a Group view of risk adjustment (i.e. including diversification benefits available as a result of being part of a diversified Group).
  - The majority of members supported the IASB's conclusion that Group diversification benefits may be considered at the entity level. The issue is around the potential inability to reflect a different level of diversification at the Group level from the level reflected in the individual subsidiary risk adjustment. However, one member suggested that the paper could include some support for the conclusion that the entity can reflect Group diversification benefits.
  - A member suggested that the paper should be clear around why it would be appropriate to reflect different outcomes at the Group and subsidiary levels.

Compensation "charged" vs compensation required

- Members expressed the view that there is only one actual price "charged" to the policyholder, although there may be multiple views of what the risk adjustment should be in determining the technical pricing that an entity would ideally charge.
  - Another member raised the point that the risk adjustment is defined as compensation an entity "would require" [IFRS 17.B87] which is different from "charged". Entities in a Group may have different risk appetites and require different levels of compensation even if it is not reflected in the price actually charged. In the member's view, the IASB seems to have ignored considerations of entity specific risk appetite and focussed instead on the word "charged".

Next steps

- Members agreed on the following next steps in relation to paper AP01:
  - Re-frame the paper so that it more directly addresses how the determination of the risk adjustment is expected to be applied, and is less focussed on rebutting the misconceptions raised by the IASB at the IASB May 2018 TRG.
  - The paper should emphasise the request for a principles based approach, rather than prescriptive methods.
  - A revised draft will be circulated to TRG members for review on 16 July 2018 for feedback to be received by 18 July 2018, so that it can be submitted to the IASB TRG by the submission deadline of 20 July 2018.

Treatment of reinsurance held on initial recognition	**AP02**

- Preparers introduced the paper and provided a summary of the key issues being raised:

- The paper was prepared by a working group of the AASB TRG and has been discussed at the life reinsurers sub-group of the AALC as well as the AALC. Feedback received from these forums have been reflected in the draft paper being discussed (AP02).
- The key issue in the paper is around the inability to reflect the reinsurance benefit on reinsurance held in the profit or loss at the same time as losses on underlying contracts where the reinsurance contracts held cover onerous underlying contracts. This results in a perceived mismatch and does not reflect the actual financial performance of the insurer and the economics of the reinsurance transaction.
- IFRS 17 Basis for Conclusions indicates that the IASB did not expect this to be a prevalent issue – they considered the occurrence of a net gain on reinsurance held to be "rare" [IFRS 17.BC310].
- The paper also seeks clarification on the application of IFRS 17.66(c)(ii) specifically around:
    i. its applicability where the underlying contracts apply the PAA – references in IFRS 17.66(c)(ii) are in relation to changes in fulfilment cash flows that "do not adjust the contractual service margin"; and
    ii. how the requirements should be applied in light of the clarification in the IASB February 2018 TRG that the measurement of reinsurance contracts held shall include all fulfilment cash flows within the boundary of the reinsurance contract, including those relating to underlying contracts not yet issued - specifically, does IFRS 17.66(c)(ii) apply in respect of changes that arise subsequent to initial recognition of the reinsurance contracts held even if the change in expectation happens before the initial recognition of the relevant underlying contracts?

- One member expressed the view that reinsurance contracts being entered into as a risk mitigant does not seem to be reflected in the principles of IFRS 17. The member also referred to paragraph 2.3 of AP02 which states that the current requirements of IFRS 17 will result in a presentation that is unhelpful to users, and suggested that the paper should further emphasise that regulators might be unlikely to accept the current IFRS 17 treatment of reinsurance held.
- Members noted that in addition to the issue covered in the paper, there are other areas where mismatches could arise between the reinsurance and the underlying contracts such as:
    - Different contract boundaries
    - Different measurement models applied
- Members discussed whether the IASB TRG is the most effective avenue to raise a request for a change in the Standard:
    - Options are to submit the paper directly to the IASB as opposed to submitting it to the IASB TRG; or to submit the paper directly to the IASB as well as the IASB TRG in order for the paper to be logged as a submission item even if rejected by the IASB TRG.
    - One member stated that the reinsurance issue being raised is prevalent in other countries globally. It was raised by several countries, including Canada and HK at the recent EFRAG Board meeting. The member suggested that raising this issue to the IASB should be a collaborative effort between Standard setters from the affected jurisdictions.
    - Another member agreed that this was a global issue, and is particularly significant across Europe. From discussions with another global reinsurer, the IASB appear to be very reluctant to make changes to the Standard for this issue.

- Members noted that if there is no success progressing this issue through the global Standard setters, the TRG may be the only avenue.

- One member noted that the IASB are working on explanatory materials which may help to clarify their thinking on reinsurance held and that it may be premature to ask for a change until that has been released. The member also noted that this is not a new issue and it has been considered by the IASB. It is therefore important to understand why the IASB concluded on the current IFRS 17 treatment and that a submission to the IASB should highlight a change in facts or present information that was not previously considered by the IASB. Members noted the following areas that should be further explored:
  - The issue has been discussed throughout the drafting of the Standard and the 2010 ED had initially proposed that the net gain should be recognised in the profit or loss on Day 1 to match the underlying loss. New evidence of the conceptual issues as well as the magnitude of the impact will therefore be important for the IASB to consider change in the Standard.
  - One member suggested that the lack of participation in the discussions around this issue between 2010 and issue of the Standard may have been due to the lack of attention on reinsurance held as stakeholders were focussed on the significant issues around the measurement of issued contracts. The member also noted the IASB's emphasis on the separate measurement of the reinsurance and underlying contracts. It was emphasised that the IASB has devoted considerable attention to onerous contracts issued and it would, therefore, be inconsistent to consider that entities would not enter into reinsurance held which would respond to cover those onerous contracts as well as profitable ones.
  - It was also highlighted that the issue is more significant now because of the introduction of "groups of contracts" which was a late addition in the Insurance Contracts project. Prior to that point, there was no estimate or indicator of the potential scale of onerous business. Consequently, reinsurance contracts in a net gain position due to covering onerous underlying contracts can no longer be considered a rarity under the current issue of the Standard, particularly after the introduction of "groups". Members agreed that this was a point to be raised in the paper to show that it is now a more significant issue than when it was previously raised.
  - Members considered that the risk adjustment of the underlying insurance contract can reflect that the contract is subject to reinsurance held. Members agreed that it could be helpful but considered that this will not fully resolve the issue around the mismatch. It was suggested that the simplified example in the paper should be revised so that the onerous losses were a result of the claims cash flows as opposed to the risk adjustment to avoid any confusion.

- The inclusion of the Proposed Solutions in the paper was discussed:
  - One member expressed concern that the inclusion of Proposed Solutions that have not been sufficiently tested could give rise to other unintended issues.
  - Another member noted that Solution 1 had been previously suggested to the IASB by a European reinsurer and was rejected. However, there doesn't appear to be a simple solution to resolve the issue, noting that Solution 2 is proposing to adjust the measurement of the underlying contracts. One member stated that hedging was a good example to illustrate the principle, however, adjustment of the underlying measurement may not be the appropriate solution. There may also be other solutions that have not been considered or that members were not aware of.

- It was agreed that the paper should be less prescriptive in terms of a solution and a more principles based approach should be proposed. The Proposed Solutions will be moved to an Appendix with narrative around the merits and pitfalls considered for each.

- The inclusion of the other interpretation issues around IFRS 17.66(c)(ii) was discussed:
  - Some members suggested that these should be included in a separate paper to the IASB.
  - Another member considered that if a solution based on the principles set out in AP02 (that allows the measurement of the reinsurance contract held to respond in the same way as the underlying insurance risks being covered) is adopted, these and other implementation issues around reinsurance are likely to be resolved.
  - Members suggested that all issues around the treatment of reinsurance held should be included as a list in a separate Appendix within the paper. One member asked if this would take away the focus from the main issue. Other members stated that the main focus will be the issue articulated in the paper as the other issues will be included in an Appendix.

Next steps

- The following actions were agreed:
  - Connect with other national Standard setters to explore how to progress the issue collectively;
  - Amend the paper to include:
    - Clear reasons why the issue is more significant than when it was first considered (introduction of groups and evidence of the magnitude of onerous contracts);
    - Example to show the impact of the subsequent measurement requirements around lapse changes relating to future business;
    - Revised simplified example so that the onerous losses are a result of the claims cash flows as opposed to the risk adjustment;
    - Request for a principles based solution which allows the treatment of reinsurance held to respond to the underlying insurance risk. The two proposed solutions should be moved to an Appendix with articulation of merits and pitfalls considered;
    - A list of other issues around the treatment of reinsurance held in an Appendix.

Update on European Financial Reporting Advisory Group (EFRAG) on IFRS 17 developments	**AP03**

- A member who attended the EFRAG Board meeting provided a summary of the discussions:
  - Presentations were made by representatives from different jurisdictions globally. There were also presentations by representatives from reinsurers and the CFO forum who participated in the field testing conducted by EFRAG in Europe;
  - A list of 13 issues were raised and there was a strong request from some preparers for a deferral of the application of the Standard;
- One member asked if there have been any requests to the AASB from Australian insurers for a deferral or non-application of the Standard – it was confirmed that there have been none so far.

Other business	**AP04**

- An APRA representative provided a summary of the APRA letter issued in May on AASB 17 and AASB 16:

- A survey was performed by APRA in September to assess how progressed Australian preparers were on the implementation of AASB 16 and AASB 17 as well to determine if there is consistency in the key issues faced by preparers. - Most respondents were in early stages in their implementation of AASB 17. There was a significant variation in the expected costs of implementation. - Key issues noted were around Reinsurance, level of aggregation and contract boundaries. - One member commented that there could be quite a big range of implementation costs which will be bespoke to the entity depending on their implementation strategy, i.e. whether transformation is being considered as part of the compliance exercise and the nature of their individual current systems and processes.	
Closing remarks	
- Actions on the two papers discussed were confirmed. - It was agreed that AP01 on risk adjustment will be updated to reflect the feedback from this meeting and subsequently submitted to IASB TRG on 20 July 2018; - AP02 on reinsurance will be updated to reflect the feedback from this meeting and subsequently raised to the IASB via the AASB in conjunction with other standard setters.	
End Meeting	