



## Meeting information

AASB 17 *Insurance Contracts* Transition Resource Group (TRG)  
17 September 2018  
9am-3pm

**Objective:** The AASB 17 TRG was asked to review the agenda papers released by the IASB for discussion at the September 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
Stuart Alexander	Deloitte
James Barden (via teleconference)	AASB staff
Cassandra Cope	HCF
Brendan Counsell	EY
Peter Grant (via teleconference)	Insurance Australia Group (IAG)
Scott Hadfield	PwC/AALC
Weldon Luo	ATO
Chris Maher	AMP
Ian Moyser (via teleconference)	KPMG
Kris Peach (via teleconference)	AASB
Rachel Poo	QBE/Deloitte
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
Ayman Sobhan	Insurance Council of Australia
Michael Sokulski (via teleconference)	Medibank
Warwick Spargo (via teleconference)	RSM Bird Cameron
Shogo Suzuki (observer)	Nippon Life
Angus Thomson (via teleconference)	QBE
Tony Tong	Pacific Life Re

ATTENDANCE	ORGANISATION
Owen Tong (observer)	BT Financial Group
Glenn Treadwell (via teleconference)	NIB
Jeroen Von Koert (via teleconference)	AIA

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Topic	Agenda paper
<b>Insurance risk consequent to an incurred claim</b>	<b>AP01</b>
<ul style="list-style-type: none"> <li>- AP01 discusses the treatment of insurance contracts under which an incurred claim results in insurance risk for the issuer that would not exist if no claim were made, specifically whether the entity’s obligation to pay amounts subsequent to a claim event (‘consequential insurance coverage’) should constitute part of the liability for remaining coverage (LfRC) [View 1] or the liability for incurred claims (LIC) [View 2]. The IASB staff view presented is that both interpretations are valid.</li> <li>- One member observed that the implications of the IASB staff views expressed in AP01 are that: <ul style="list-style-type: none"> <li>• View 1 will have implications for the determination of the coverage period, i.e. the coverage period for some contracts could be extended under this view as it will include the claims development period; and</li> <li>• the IASB staff view that both interpretations are valid could lead to inconsistencies in practice if different approaches are adopted for similar products</li> </ul> </li> <li>- Members discussed the two views presented in AP01: <ul style="list-style-type: none"> <li>• One member commented that the key question appears to be around the definition of the ‘insured event’. Another member questioned whether View 1 has developed as a result of the IFRS 17 requirements around adverse development reinsurance covers (ADCs) and the acquisitions of claims liabilities where the insured event is deemed to be the determination of the ultimate cost of claims<sup>1</sup>.</li> <li>• Some members considered that there may be a diversion of views between the life insurers and general insurers, whereby some life insurance entities may consider that View 1 is appropriate for their annuity products whilst general insurance entities are more likely to apply View 2 to similar general insurance products such as Bodily Injury claims. Some members also stated that under current practice, View 2 is more likely to be applied to account for the fire insurance example presented in AP01.</li> <li>• One member considered that claims development tables are likely to be less relevant for products applying View 1 as ‘claims development’ will be reflective of the claims payment patterns.</li> </ul> </li> <li>- Some members supported the optionality provided by AP01 by allowing the use of judgement when determining which approach to be applied. Other members commented that although they were generally supportive of allowing flexibility in applying the principles of the Standard, there are concerns in this case around the potential diversity in practice that could</li> </ul>	

<sup>1</sup> IFRS 17.B5 states that for insurance contracts that cover events that have already occurred but the financial effect of which is still uncertain, the insured event is deemed to be the determination of the ultimate cost of the claims.

arise if different approaches are adopted by different entities. One member expressed the view that a consistent approach should be applied for products with the same set of facts within a jurisdiction.

- Members also considered the implications of paragraph 21 of AP01, which states that the IASB may take action if widespread diversity emerges as practice develops. Some members highlighted that if changes are introduced by the IASB in the future, it could result in additional costs to change systems where a different approach had been applied initially.
- One member asked if introducing disclosure requirements could be a solution to mitigating potential issues arising from diversity in practice. Other members responded that disclosure requirements are unlikely to be sufficient as the approach taken will have implications for contract boundary and measurement which are unlikely to be able to be clearly presented through disclosures.
- Overall, members did not object to the optionality provided by AP01 but consider that there is a need to highlight the potential implications of the optionality as well as implications if the IASB introduces different requirements in the future as a result of diversity in practice.

## **Determining discount rates using a top-down approach**

**AP02**

- AP02 discusses the approach to determining discount rates using a top-down approach. AP02 concludes that:
  - a portfolio of assets an entity holds can be used as a reference portfolio as long as the discount rates achieve the objectives in IFRS 17.36 to reflect the characteristics of the insurance contracts and are consistent with observable current market prices
  - an entity is required to eliminate any differences resulting from characteristics of the assets that are not present in the insurance contracts but is not required to adjust the yield curve of a reference portfolio of assets for differences in liquidity characteristics
- One member expressed agreement with the conclusions of the paper and considered that the simplification provided by IFRS 17.B81 (paragraph 20 of AP02) is a useful expedient.
- A member asked about the extent to which the top-down approach is likely to be applied in Australia. Another member considered that it is unlikely that many entities will apply the top-down approach but noted that Australian entities that are foreign subsidiaries of global Groups may apply the top-down approach to be consistent with the approach adopted by their parent entity. Another member agreed and considered that the application of the top-down approach is likely to be prevalent in Asia. The member also noted that local capital requirements may continue to be based on a bottom-up approach and can therefore, give rise to differences between reporting bases for those entities applying the top-down approach.
- Overall, members agreed with the conclusions in paper AP02.

## **Commissions and reinstatement premiums in reinsurance contracts issued**

**AP03**

- AP03 considers how ceding commissions and reinstatement premiums should be accounted for by the reinsurer. AP03 concludes that:
  - Ceding commissions that are not contingent on claims (and are not investment components) are considered to be part of premiums and do not meet the definition of acquisition costs unless the cedant provides a distinct service to the reinsurer for selling, underwriting or starting the contract resulting in a cost.
  - Ceding commissions contingent on claims are treated as part of claims.
  - Some ceding commissions may meet the definition of an investment component if they are repaid to the policyholder in all circumstances.

- The economic effect of mandatory reinstatement premiums is equivalent to reimbursing a different amount of claims to the cedant. The economic effect of voluntary reinstatement premiums is equivalent to charging a higher premium to extend contract coverage.
- One member observed that the IASB staff have framed their conclusions based on the economic effect of the transactions being considered. The member noted that the IASB conclusions will have implications for metrics – for example, the requirement to recognise ceding commissions as part of revenue will mean that revenue could be materially diluted under IFRS 17. One member agreed that the conclusions have implications for the amount of revenue recognised but did not consider them to be inappropriate. Another member considered that the implications on metrics may lead to a change in some legacy commission terms and practices in some entities.
- One member considered that the treatment of mandatory reinstatement premiums as part of claims will result in the loss of information about coverage utilisation. The member expressed the view that mandatory reinstatement premiums are effectively additional premiums for additional cover and that their nature as premiums does not change based on whether they are voluntary or mandatory. Other members considered that the lack of choice in relation to mandatory reinstatement premiums is relevant and that the conclusion in AP03 that they should be treated as part of claims is reasonable based on the framework of IFRS 17.
- A member asked whether the treatment of mandatory reinstatement premiums as claims is a disconnect from pricing which would be based on a consideration of premiums, including reinstatement premiums. Some members responded that reinsurers commonly consider net profit and would therefore, be indifferent to the treatment of reinstatement premiums as either premiums or claims.
- Members also considered whether the requirement for the reinsurer to treat mandatory reinstatement premiums as part of premiums would also be reflected by the cedant. Members did not conclude but one member observed that a cedant is not required to disclose reinsurance income and expenses separately due to the option provided by IFRS 17.86 to allow the presentation of reinsurance income and expenses as a single amount.
- Members discussed the treatment of some ceding commissions as investment components.
- One member expressed the view that the requirement to treat some amounts as investment components could result in increased operational complexity. It was noted that the extent of ceding commissions in Australia which are required to be treated as investment components is not clear.

<b>Premium experience adjustments related to current or past service</b>	<b>AP04</b>
<p>- AP04 considers how differences between expected and actual premiums (‘premium experience adjustments’) should be accounted for, and also addresses whether the principles are similar when applying the general model and the premium allocation approach (PAA). AP04 concludes that:</p> <ul style="list-style-type: none"> <li>• Under the general model, premium experience adjustments that relate to current or past service should be recognised in the P&amp;L immediately as part of insurance revenue.</li> <li>• The mechanics for recognising insurance revenue applying the PAA are different to the mechanics for recognising insurance revenue applying the general model. Premium experience adjustments are allocated to the P&amp;L on the basis of passage of time or expected timing of incurred insurance service in accordance with IFRS 17.B126.</li> </ul>	

- One member noted that the paper provided clarity around when premiums received would be considered to relate to future service as opposed to past or current service. Another member agreed and considered that the examples provided are helpful.
- Some members considered that the conclusions in AP04 were inconsistent with the outcomes of the requirement in IFRS 17.44(e) to allocate the CSM to the P&L for the provision of services in each period based on the CSM balance at the end of the reporting period because the CSM amounts allocated to P&L will include the effect of adjustments to the CSM relating to future service. One member stated that the IASB may have considered that adjustments relating to future service are based on assumptions that have changed during the reporting period, as opposed to at a point in time. The IASB therefore, considered it to be appropriate for some of these changes to be reflected in the P&L in the current period. Another member stated that in practice, assumptions are changed at the end of the reporting period which is the valuation date. One member expressed the view that if IFRS 17 required the allocation of CSM to P&L in each period before adjustments relating to future services, it could result in other undesirable outcomes.
- Overall, members agreed with the conclusions in AP04 but noted that the outcomes of those conclusions should be considered in conjunction with the effect of IFRS 17.44(e).

Industry pools managed by an association	AP09
<ul style="list-style-type: none"> <li>- AP09 discusses the level at which the risk adjustment for non-financial risk should be determined for insurance contracts within industry pools managed by an association. AP09 concludes that the risk adjustment is determined by the issuer of the contracts. The IASB staff view is that for a group of insurance contracts, there is one risk adjustment which reflects the diversification benefit considered by the issuer, but AP09 acknowledges that some IASB TRG members have a different interpretation of the requirements (AP09 paragraph 26).</li> <li>- One member considered that it may be possible for a parent entity within a Group to prescribe the approach applied by the subsidiary to determine the individual subsidiary risk adjustment (including the level of diversification benefit to be considered), but questioned the ability of an association of an industry pool to prescribe the risk adjustment to be applied by individual members in order to achieve an appropriate risk adjustment at the association level.</li> <li>- Members considered that the conclusions in AP09 would not impact similar schemes in Australia such as Health and CTP equalisation schemes, and are therefore, likely to have limited application in Australia. One member stated that the conclusions may have implications for other markets for example the Lloyds market in the UK where underwriting may be performed by a lead underwriter with subsequent underwriters accepting a % on the same terms and conditions as the lead underwriter.</li> <li>- Members discussed the principle in AP09 that there is one risk adjustment for a group of insurance contracts. Some members expressed the view that the alternative interpretation referred to in paragraph 26 of AP09 is not contradictory with the IASB's conclusion but is a broader interpretation which encompasses the IASB staff conclusion in AP09.</li> </ul>	
Recovery of insurance acquisition cash flows	AP06
<ul style="list-style-type: none"> <li>- AP06 considers whether insurance acquisition cash flows and the related revenue are recognised in P&amp;L if those cash flows are not recoverable. It also addresses how to account for changes in insurance acquisition cash flows applying IFRS 17.B123 and IFRS 17.B125. AP06 concludes that: <ul style="list-style-type: none"> <li>• An entity is not required to determine how much of the premium relates to recovering other cash flows incurred in fulfilling the contracts.</li> <li>• IFRS 17.B125 assumes that the portion of premiums relating to the recovery of insurance acquisition cash flows is equal to the current estimate of total expected</li> </ul> </li> </ul>	

insurance acquisition cash flows at each reporting period. IFRS 17.B123 and IFRS 17.B125 should be considered together and not in isolation.

- Changes in expectations of insurance acquisition cash flows adjust the CSM. The actual amount of insurance acquisition cash flows should be recognised as expenses.
- One member commented that the relationship between IFRS 17.B123 and IFRS 17.B125 is not clear. The member suggested that acquisition expenses should be treated in the same way as other expenses, i.e. they should be recognised in the P&L when they are incurred. Another member responded that if all acquisition costs are required to be recognised in the first year, this would result in a distortion of expense ratios. The member also considered that although the requirements in IFRS 17 around the treatment of expenses is not always clear, the requirements are logical and the examples provided in AP06 are helpful.
- Overall, members agreed with the conclusions in AP06.

## Premium waivers

AP07

- AP07 discusses the treatment of premium waivers which allow the policyholder to avoid paying premiums in specified circumstances. AP07 concludes that the risk related to the premium waiver is an insurance risk and is not a new risk created by the contract.
- The IASB staff observed in AP07 that a consequence of the conclusions is that the inclusion of such a waiver in an investment contract makes the investment contract an insurance contract. Some members considered that this will have significant implications for other jurisdictions where those contracts are more prevalent. A member stated that premium waivers exist in some Australian health insurance products.
- One member questioned whether the “significance” of the insurance risk is relevant. Members considered that there will still need to be significant insurance risk in accordance with IFRS 17.B17.
- Members agreed with the outcomes of AP07.

## Group insurance policies

AP08

- AP08 discusses the accounting for an arrangement between an insurer and an association whereby the insurer provides coverage to members of an association (“certificate holders”). AP08 considers a specific fact pattern and concludes in relation to those specific facts and circumstances that although the legal form of the arrangement is represented by a single contract with the association, the arrangement described reflects multiple contracts with individual certificate holders.
- One member considered the application of the conclusions to superannuation insurance where the party adversely affected by an event could be the trustee instead of the beneficiary. The member considered that the insurance contract is protecting the trustee and not the individual beneficiaries in those circumstances as the trustee would have an obligation to reimburse the beneficiaries even if the insurance contract was not in place. Another member pointed out that in the specific fact pattern discussed in AP08, the certificate holders had a discretion as to whether to participate in the insurance contract.
- Some members considered if the conclusion would be different if the certificate holders are required to participate in the insurance arrangement. No conclusion was reached but members highlighted that the conclusion in AP08 was in relation to a narrow fact pattern. Members also noted that it was unclear how the conclusions would apply to lenders mortgage insurance where the insurance contract is entered into with the bank to cover the potential losses that could be incurred by the bank if the underlying borrower is unable to repay the loan.



- One member observed that there are products in Australia (e.g. medical and legal defence products) that are likely to have arrangements that are similar to those described in AP08 and this paper would be a good reference point for determining their approach under IFRS 17.
- Another member noted that even where a legal contract is deemed to be multiple contracts with individual certificate holders, these contracts could still constitute a single group under IFRS 17 and therefore, measurement could still be performed at the level of the master contract. However, onerous groups would require separate identification.
- Members agreed that AP08 highlights that although the IASB February TRG (AP1) clarified that the legal form of a single contract is presumed to be the lowest unit of account, there are circumstances where it may be appropriate to treat the contract as multiple contracts in order to reflect the substance of the arrangement.
- Overall, members agreed with the conclusions in AP08 and considered that they were a useful reference point. However, members also noted that it was important to highlight that the conclusions were in relation to a very narrow fact set, and that the facts and circumstances or each arrangement will need to be considered.

<b>Cash flows outside the contract boundary at initial recognition</b>	<b>AP05</b>
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- AP05 discusses when a reassessment of contract boundary in accordance with IFRS 17.B64 would result in cash flows that were outside the contract boundary become included in the contract boundary (or cash flows that were inside the contract boundary become excluded from the boundary).
- One member considered that the paper was helpful as it provided an example of a pricing constraint that had commercial substance.
- A member asked if this would impact contracts where the price is contractually restricted for a number of years. Another member responded that CTP is an example of where repricing of contracts are regulated and could be impacted. The member also expressed the view that where repricing is restricted for a number of years, there could be practical difficulties around identifying when a restriction that had no commercial substance could subsequently have commercial substance and therefore, impact the contract boundary.
- Another member noted that Health Insurance is a heavily regulated sector, however, health insurers would commonly consider alternative commercial options (such as entering into new contracts) where the terms of existing contracts are no longer deemed to be commercial.
- One member stated that the implication of the contract boundary reassessment should be considered when performing PAA eligibility testing, i.e. when testing for PAA eligibility, entities should consider the potential for a longer contract boundary due to constraints becoming applicable in subsequent periods.
- Overall, members agreed with the conclusions in AP05 but noted the possible practical implications of the requirement to reassess the contract boundary in each period.

<b>Annual cohorts for contracts that share in the return of a specified pool of underlying items</b>	<b>AP10</b>
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- AP10 considers the applicability of annual cohorts to policies that share in a specified pool of underlying items, in particular, when the CSM can be measured at a higher level (e.g. portfolio and achieve the same outcome as measurement by annual cohort. AP10 concludes that:
  - For contracts with policyholders that share in 100% of the returns on a pool of underlying items (fully share risks), measuring the CSM at a higher level than annual

cohort level (e.g. portfolio) would achieve the same outcome as measuring the CSM at an annual cohort level.

- For contracts that do not fully share risks, the CSM when measured at a higher level may differ from the CSM measured at an annual cohort level.
- One member considered that the chances of an individual group becoming loss making is very small, even where the contracts do not fully share risks as for most participating business, the claims would ordinarily be immaterial relative to the investment returns.
- A member questioned the prevalence of impacted business in Australia. Another member considered that most life insurers will have some impacted business although it may not be material for some entities. Members considered that the impact is expected to be larger in Europe and noted that annual cohorts is listed as one of the six topics on the letter submitted by EFRAG to the IASB.
- Members agreed that although they consider that the measurement of the CSM should be allowed to be performed at a higher level than annual cohorts, the issue is likely to be more prevalent in Europe and Canada.

## Reporting on other questions submitted

AP11

- Members considered all the submissions in AP11.

### *S33 – Separating components from an insurance contracts*

- It was noted in ‘S33 – Separating components from an insurance contract’ that an entity may be required to account for loans and other forms of credit that include a relatively small insurance component entirely as insurance contracts, and that the IASB staff plan to bring this to the attention of the IASB Board. One member asked if a relatively small insurance component could be considered to transfer significant insurance risk. Another member responded that the significance of the insurance risk should be considered in relation to the insurance component, not the transaction as a whole – for example, for a unit linked contract with a highly inter-related risk rider, the significance of the insurance risk will be considered in relation to the rider. Members supported the IASB staff’s intention to consider the application of IFRS 17 in relation to the contracts being discussed but requested for additional clarity around the issue the IASB staff is intending to present to the IASB Board.

### *S81 – Determining the risk adjustment for non-financial risk in a group of entities*

- A member noted that the inclusion of this topic in the log presents an opportunity to clarify that the alternative view provided by the Australian submission encompasses the IASB staff view presented in AP2 of the IASB May TRG and is not a mutually exclusive view.

### *S21 and S45- Accounting for insurance contracts issued by mutual entities*

- Members agreed that the topic is unlikely to be a significant issue in Australia but suggested that the IFRS 17 educational materials on how IFRS 17 applies to insurance contracts issued by a mutual entity requires more clarity.

### *Other submissions*

- No other issues were raised on the submissions and conclusions presented in the paper.

## Australian submission: CTP Insurance contract Boundary

AP12

- AP12 was drafted by a working group of the Insurance Council of Australia (ICA). Members noted that the AASB TRG cannot provide accounting advice and accordingly, the paper is only tabled for the discussion and comments from members and not for endorsement.
- Preparers introduced the paper and provided a summary of the issues addressed:



- The paper considers how to apply the contract boundary requirements to CTP products, and in particular, how restrictions to pricing and underwriting could be considered when determining the IFRS 17 contract boundary.
  - The paper concludes that the restrictions considered do not restrict the insurer's practical ability to reprice for reassessed risks because commercial factors are considered by the government when setting the restricted rates. The paper also considers that the fact that an insurer can exit the market is a relevant factor.
  - The paper also considers other situations that may result in cross subsidisation over a set period for example where there are transitional arrangements on privatisation of CTP.
  - The paper is not intended to be used as accounting guidance but could be a useful discussion paper for entities considering the application of the IFRS 17 contract boundary requirements for similar products.
- One member commented that the paper could help others with CTP or similar products to understand some of the considerations they need to take into account in determining contract boundary. No further comments or issues were raised on the content of the paper.

### **Any other business**

- A member provided an update on the reinsurance paper presented at the previous AASB TRG meeting (AASB TRG 13 July 2018 – AP02):
- It was agreed at the July 2018 AASB TRG that the paper on the treatment of reinsurance held would not be submitted for discussion at the September IASB TRG, but would instead be presented directly to the IASB as it would require a change to IFRS 17.
  - The AASB is working with other Standard setters in order to identify a constructive approach to presenting the issue to the IASB. Members of the working group and the AASB have discussed the issue and proposed approach with representatives of the Standard setters as well as the IASB and are working to refine the arguments and proposed solutions in the paper for discussion with the IASB in early October.
- The next AASB TRG is planned for the 26 November 2018.

### **End Meeting**