AASB Transition Resource Group for AASB 17 *Insurance Contracts*
Submission form for potential implementation question

In addition to the form, attachments (such as memos) may be included with the submission.

Any public discussion of issues submitted will be without the identification of the submitter's name. Although the submission forms will remain private, please do not include any confidential information in your submission.

Email a PDF of the completed (including any attachments) form to standards@aasb.gov.au.

Submission date	10/03/2023
Name	Rhian Saunsbury
Title	Manager, Group Accounting Policy and Advisory
Organisation	QBE
Address	380 George Street, Sydney, NSW, 2000
Telephone	Click here to enter text.
Email address	Rhian.Saunsbury@qbe.com
Stakeholder group	Preparer
Do you wish to present to the TRG?	Yes

Potential implementation question

Contract boundary of reinsurance contracts held with the ARPC for cyclone risks – please see Questions on page 4.

The issue was considered at the December 2022 AASB 17 TRG meeting and it was decided that input also be sought from the Accountants' and Actuaries' Liaison Committee and to report back to the AASB 17 TRG.

Paragraph of IFRS 17 *Insurance Contracts*

AASB 17.34 and AASB 17.B64

Analysis of the question

The analysis of the question should include a detailed description of the different ways the new Standard may be applied, resulting in possible diversity in practice.

Please see the Appendix

Is the question pervasive?

Explain whether the question is expected to be relevant to a wide group of stakeholders.

Yes – all insurers accepting cyclone risks will be required to reinsure through the Australian Reinsurance Pool Corporation (ARPC)

Appendix – ARPC reinsurance contracts held contract boundary

December 2022 AASB 17 TRG meeting

1. The background on the Australian Reinsurance Pool Corporation (ARPC) cyclone pool arrangements noted at the December 2022 AASB 17 TRG meeting is in Addendum A (below).

2. At the December 2022 AASB 17 TRG meeting, the following key distinguishing features of ARPC Cyclone Loss Reinsurance Arrangements were noted.

   - It is mandatory to have ARPC reinsurance contract held coverage for the relevant underlying insurance contracts providing cyclone coverage.
   - Pricing and benefits are set by the ARPC – there is no facility for insurers to negotiate. The *Terrorism and Cyclone Insurance Act 2003*, section 8D says:

     When setting premiums that reinsureds are to pay under cyclone reinsurance contracts, the Corporation is to seek:

     (a) to ensure that, over the longer term, premiums paid under such contracts are sufficient to cover or offset:

       (i) the amounts paid in meeting the Corporation's liabilities under such contracts (including payments by the Commonwealth under section 35A in respect of such liabilities); and

       (ii) all other amounts applied by the Corporation as mentioned in subsection 34(1), in so far as those amounts may reasonably be regarded as connected with the cyclone reinsurance scheme; and

     (b) in so far as those premiums are for reinsuring liability under pool insurance contracts that involve medium to high levels of exposure to eligible cyclone losses—to keep the premiums as low as possible while maintaining incentives to reduce and mitigate the risk of eligible cyclone losses; and

     (c) in so far as those premiums are for reinsuring liability under pool insurance contracts that involve lower levels of exposure to eligible cyclone losses—to keep those premiums at levels comparable to what would be charged by other reinsurers.

3. At the December 2022 AASB 17 TRG meeting, the three possible Views on the contract boundary of ARPC Cyclone Loss Reinsurance Arrangements were considered:

   View 1: perpetual;

   View 2: determined by reference to the insurer's foreseeable commercial expectations for issuing insurance contracts that cover cyclone risks; or

   View 3: determined by reference to the contract boundaries of the insurer's underlying in-force insurance contracts issued plus those that would be expected to be issued during the six-month notice period under Clause 1(e) of the ARPC reinsurance contract.

4. The three Views are explained in more detail in Addendum B (below).

5. At the December 2022 AASB 17 TRG meeting, discussion focused on View 2 and View 3.

   - Some members considered it would be appropriate to determine the contract boundary of the reinsurance contract held based on the contract boundary of the in-force underlying contracts while others noted this to be inconsistent with their understanding of how AASB 17.34 operates.

- Some members noted that it could be difficult under View 3 for the cedant to argue that it can avoid being compelled to pay the reinsurance premium by merely having the ability to stop writing cyclone cover and that the intention to discontinue covering cyclone risk would need to be demonstrated, for example, via a business plan or strategy.

6. There was no consensus identified at the December 2022 AASB 17 TRG meeting.

7. The TRG agreed that the topic should be put forward for consideration at the February 2023 Accountants' and Actuaries' Liaison Committee (AALC) meeting and should come back to the March 2023 meeting of the AASB 17 TRG.

February 2023 AALC meeting

8. The AALC was asked essentially the same questions as those posed to the TRG in December 2022 and members were specifically asked, if you agree with View 3, what is your basis for supporting that View:

    (a) the 'same constraint applies to new and existing contracts' basis [AASB 17.B64];

    (b) the 'exit the market for cyclone risks' basis; or

    (c) some other basis and, if so, what is that basis?

9. While there were no definitive outcomes from the discussion, the following perspectives were discussed.

10. **Perspective A**: The key factor is an insurer's ability to stop providing cyclone coverage, while still issuing contracts that cover other property risks. There is a precedent for this relating to insurers that have stopped providing flood coverage under contracts relating to property risks in flood-prone areas. Accordingly, while it may be considered impracticable for an insurer to exit the market for issuing contracts covering property risks entirely in cyclone-prone areas, it would be commercially realistic to consider that an insurer might continue issuing contracts in cyclone-prone areas that specifically exclude cyclone risk. Perspective A supports View 3.

11. **Perspective B**: The line of argument in Perspective A above would be subject to other evidence about an insurer's intentions. For example, an insurer's business plans and investor presentations might indicate the insurer plans to continue providing cyclone coverage and, therefore, will need to continue receiving ARPC reinsurance coverage in periods beyond the existing in-force contract coverage periods. Perspective B supports View 2.

12. Whether AASB 17.B64 supports View 3 appears to largely depend on your perspective of the breadth of circumstances to which it should apply. There appear to be at least two viewpoints.

13. **Perspective C**: AASB 17.B64 applies insurance contracts issued and reinsurance contracts held. Because the ARPC charges the same prices and provides the same benefits to all market participants, the entity does not face constraints in obtaining the same price for ARPC reinsurance coverage whether it cancelled its existing ARPC coverage and obtained new reinsurance coverage with ARPC or simply extended its existing reinsurance coverage with ARPC. This perspective supports View 3.

14. **Perspective D**: AASB 17.B64 applies only to cases in which the entity is free from constraints in pricing its existing in-force insurance contracts issued on the same basis as new insurance contracts issued with the same characteristics. Perspective D provides no support for View 3.

15. **Perspective E**: The reference in AASB 17.B64: "… 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" means the ARPC reinsurance

contract held boundary is not extended by the prospect of future underlying insurance contracts issued. Provided the insurer can reprice its future insurance contracts issued to factor in any changed pricing for ARPC reinsurance, those future insurance contracts issued are irrelevant to determining the ARPC reinsurance contract held boundary. Perspective E supports View 3.

16. Perspective E seems consistent with the IFRS 17 TRG observation[1] that: "… a constraint that limits an entity's practical ability to price or reprice contracts differs from choices that an entity makes (pricing decisions), which may not limit the entity's practical ability to reprice existing contracts in the way envisaged by paragraph B64 of IFRS 17".

Questions for AASB 17 TRG

Q1: Do any members consider that View 1 (the contract boundary of ARPC Cyclone Loss Reinsurance Arrangements is perpetual) should apply? That is, are members satisfied that either View 2 or View 3 should apply?

Q2: Which, if any, of the above Perspectives A to E do you support?

Q3: Are there any perspectives, in addition to Perspectives A to E, that might help resolve the issues around the ARPC reinsurance contracts boundary? If so, what are those perspectives?

1 IFRS 17 TRG Meeting May 2018, Meeting Summary, paragraph 19: https://www.ifrs.org/content/dam/ifrs/meetings/2018/may/trg-for-ifrs-17/trg-for-ifrs17-meeting-summary.pdf

Addendum A – background on ARPC cyclone reinsurance arrangements

The background on the Australian Reinsurance Pool Corporation (ARPC) cyclone pool arrangements noted at the December 2022 AASB 17 TRG meeting is outlined below.

(a) Large insurers[2] must join the Australian Reinsurance Pool Corporation (ARPC) reinsurance pool for cyclones and related flood damage before 31 December 2023, and insurers can progressively transfer eligible cyclone policies up to this date.

(b) Insurers will pay the eligible reinsurance premium[3] into the pool and for the first 3 years (1 July 2022-1 July 2025) the pool will cover all eligible cyclone and related flood damage above the policyholder excess. From 1 July 2025 the pool will operate on a risk sharing arrangement with insurers.

(c) Claim recoveries under the reinsurance contract are unlimited (above the underlying policyholder's retention limit[4]) and backed by Government guarantee. Insurers can purchase other reinsurance covers to cover the post 48 hrs risk and any additional risk as they see fit.

(d) The ARPC may cancel the reinsurance contract between insurer and ARPC based on the following [Clause 1(f)]:

   (i) Insured has failed to comply with its material obligations and non-compliance is not rectified within 90 days

   (ii) Insured has committed fraud in connection with the reinsurance agreement

   (ii) Repeated failure of compliance with obligations over at least 6 months

   (iv) Failure to remit reinsurance premium within 30 days

   (v) If the Corporation reasonably considers termination/ repeal/ amendment of the Act is necessary.

(e) An insurer can cancel based on the following Clause 1(e):

> The reinsured may terminate this Agreement by giving the Corporation not less than 6 months' written notice of its decision to terminate the Agreement. The Agreement shall terminate with effect from the next 1 January that is at least 6 months after the written notice is given if the Reinsured is a *Lloyd's underwriter*, otherwise the Agreement shall terminate at the date and time specified in the written notice given pursuant to this sub-clause.

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2 That issue policies with GWP of $300m or more cyclone related premium

3 Set by the ARPC.

4 In relation to the contract issued from the insurer to the policyholder. There is no retention limit under the reinsurance contract held.

Addendum B

Outline of competing Views considered in December 2022 AASB 17 TRG meeting

View 1: perpetual contract boundary

B.1 The ARPC is a monopoly reinsurance provider and, based on current legislation, stands ready to reinsure all cyclone risks, meaning an insurer is entitled to receive reinsurance coverage from the ARPC, and similarly is obligated to pay reinsurance premiums from the ARPC for as long as the current legislation remains in place.

B.2 A possible implication of the features of an ARPC reinsurance contract held under AASB 17 would be a contract boundary that is perpetual because insurers may have no option to cease the obligation to pay premiums under AASB 17.34 into the scheme (unless they cease writing eligible cyclone risks/policies).

B.3 The cash flows associated with an ARPC reinsurance contract held would be all the expected cash flows from substantive rights and obligations under the contract with the ARPC into the foreseeable future, and the insurer's ability to cease writing eligible cyclone risks/policies is not a relevant consideration.

View 2: determined by reference to insurer's foreseeable commercial expectations

B.4 The ARPC is a monopoly reinsurance provider and, based on current legislation, stands ready to reinsure all cyclone risks for so long as an insurer expects to be issuing insurance contracts covering cyclone risks.

B.5 An ARPC reinsurance contract held contract boundary would be determined by reference to an insurer's commercial expectations about issuing insurance contracts covering cyclone risks for the foreseeable future.

B.6 The foreseeable future period may be based on the insurer's corporate business plans and forecasts, which, for example, could span three or five years. Alternatively, an insurer might re-assess annually whether it will retain the cyclone coverage within its insurance contracts – that is, while an insurer might continue to issue contracts in cyclone-affected areas, it may annually review whether to exclude cyclone risks.

B.7 Therefore, if an insurer were to review its decision to continue writing eligible cyclone risks on an annual basis, the expected cashflows (and therefore contract boundary[5]) would be based on the annual business written.

View 3: determined by reference to in-force underlying issued insurance contract boundaries

B.8 The alternative view is that an ARPC reinsurance contract held contract boundary would be determined by reference to the contract boundaries of the insurer's underlying in-force insurance contracts issued plus those that would be expected to be issued during the six-month notice period under Clause 1(e) of the ARPC reinsurance contract on one or both of two possible bases:

- having to reinsure with the ARPC is a constraint that applies to both new and existing contracts/ insurers; and/or

5 Noting that the reinsurance is written on a risks-attaching basis, so likely a 24 month contract boundary on the assumption that the underlying policies are annual and written on an equal frequency throughout the year.

- the insurer can exit the market for cyclone risks once its existing in-force contracts expire[6].

Basis for View 3 is that the same constraint applies to both new and existing contracts

B.9 IFRS 17 Transition Resource Group [May 2018] agenda paper 3 notes that:

> 26 A constraint that equally applies to new contracts and existing contracts would not limit an entity's practical ability to reprice existing contracts to reflect their reassessed risks. This is because, as explained in paragraph B64 of IFRS 17, the entity could either:
>
> (a) set the same price for an existing contract and a new contract with the same characteristics (see paragraph 34(a) of IFRS 17); or
>
> (b) reprice an existing contract to reflect overall changes in the risks in a portfolio, even if the price set for each individual policyholder does not reflect the change in risk for that specific policyholder (see paragraph 34(b) of IFRS 17).

B.10 AASB 17.B64 is relevant to ARPC reinsurance contracts held because they must be acquired due to a legislative constraint that applies equally to new and existing insurance contracts issued for cyclone risks. The constraint is that insurers must acquire reinsurance coverage from the ARPC, which is a monopoly reinsurer for the at least the first tranche of risk.

B.11 That is, ARPC cyclone reinsurance coverage is always available at the current price to all participating insurers on the same basis. Accordingly, for example, a perpetual reinsurance contract held with the ARPC would have the same pricing and same level of benefits as a series of 6 monthly reinsurance contracts held with the ARPC into perpetuity.

B.12 In addition, based on the requirements imposed by section 8D of the *Terrorism and Cyclone Insurance Act 2003*, the APRC is obliged to ensure the 'current price' is benchmarked to a competitive price that would be fully reflective of the risks reinsured.

Basis for View 3 is that the private sector insurer could exit the market for cyclone risks

B.13 An ARPC reinsurance contract held contract boundary is limited by the contract boundaries of the insurer's underlying in-force insurance contracts issued because an insurer could elect to stop issuing insurance contracts that provide coverage for cyclone risks and, therefore, end its obligations to cede premiums to the ARPC [with six-month notice under Clause 1(e)].

B.14 While this may, or may not, be a commercially viable option for many insurers, it can be argued that this is not a relevant consideration[6]. This is because the insurer's coverage of cyclone risks is within its control. The insurer could choose to exclude cyclone risks from the insurance contracts it issues, which would allow the insurer to end its ARPC reinsurance contract held contract boundary once the contract boundaries under its existing in-force insurance contracts issued expire (providing 6 months' notice to the ARPC).

6 Noting that the AASB TRG/ ICA paper (September 2018) discussing contract boundaries of CTP Insurance stated the importance of having the practical ability to exit the market when considering a contract end boundary irrespective of whether it's a commercially rationale decision.

Addendum C – relevant extracts from AASB 17 and the IFRS 17 Basis for Conclusions

C.1 Under AASB 17.34, the contract boundary for the purposes of identifying cash flow under an insurance contract issued or reinsurance contract held, ends when the insurer/cedent has the practical ability to reprice the relevant risks and benefits.

> 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 insurance contract services (see paragraphs B61–B71). A substantive obligation to provide insurance contract services ends when:
>
> (a) the entity has the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects those risks; or
>
> (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 up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date

C.2 Under AASB 17.B64, an insurer/cedent is identified as having the practical ability to reprice in the absence of constraints that prevent the entity from setting the same price as for a new contract (emphasis added).

> 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 service. 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.

C.3 The IFRS 17 Basis for Conclusions notes that estimates of future cash flows included in measuring reinsurance contracts relate to insurance contracts the entity expects to be covered by the reinsurance.

> BC309A **Estimates of future cash flows included in the measurement of a group of reinsurance contracts held include future cash flows that relate to insurance contracts an entity expects to be covered by the reinsurance contracts held in the group. Such cash flows include cash flows related to insurance contracts the entity expects to issue in the future if the entity has a substantive right to receive reinsurance coverage for those insurance contracts**. The Board considered a suggestion from entities implementing IFRS 17 to amend IFRS 17 to exclude from

the measurement of the group of reinsurance contracts held cash flows that relate to underlying insurance contracts that are yet to be issued.

BC309B The Board noted that the suggestion in paragraph BC309A, which is consistent with feedback during the development of IFRS 17, would achieve an outcome similar to the practice often used applying IFRS 4 whereby an entity measured reinsurance contracts held based on the measurement of existing underlying insurance contracts

BC309C The Board reaffirmed its view that the accounting for a reinsurance contract held should be consistent with the accounting for insurance contracts issued (see paragraph BC298). Consistent accounting includes measuring the expected value of all the entity's rights and obligations arising from a contract. When an entity holds a reinsurance contract that provides the entity with a substantive right to receive reinsurance coverage for insurance contracts it expects to issue, cash flows arising from that substantive right are included in the measurement of the reinsurance contract held (that is, those cash flows are within the boundary of the reinsurance contract held applying paragraph 34 of IFRS 17). …