IFRS 17 Transition Resource Group September meeting summary

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The two-day September meeting may be the last meeting for several months as issues submitted are becoming more and more focused on applying the IFRS 17 Standard rather than on its interpretation.

The IFRS 17 Transition Resource Group ("TRG") met at the offices of the International Accounting Standards Board ("IASB") on September 26 and 27. This paper summarizes the eleven papers discussed and the IASB staff's summary of the discussion[1]. The IASB staff ("the Staff") will publish their official summary of the meeting in the upcoming weeks. The IASB received a total of 32 new submissions for consideration at the September TRG meeting. TRG Chairman Martin Edelmen described the submissions as more focused on mechanical issues with highly specific fact patterns, rather than interpretation of the words of the standard which is supposed to be the focus of the TRG. Given the trend in the submissions and the short time period between the September meeting and the next scheduled meeting at the beginning of December, the Staff is considering moving the next TRG meeting to March 2019.

Insurance Risk Consequent to a Claim [AP01]

The first agenda paper considered the issue of whether a claim resulting in insurance risk would be accounted for as a liability for incurred claims or a liability for remaining coverage. Two examples in the staff analysis include a disability claim with ongoing regular payments and the rebuild of a property following a fire claim.

The determination of the appropriate accounting could affect the determination of the coverage period for the contract and thus whether some changes in fulfilment cash flows would adjust the CSM and its amortization.

The Staff analysis concluded that the standard could be read to support either approach and that insurers would have to choose an accounting policy based on the facts and circumstances of the products they issue.

There was some concern expressed about inconsistent treatment of similar products under current accounting rules and that this would continue under IFRS 17 if both approaches were valid. Some members suggested that examples of situations where one approach was clearly the more appropriate would provide helpful guidance and lead to more consistency across the industry.

The discussion clarified that the Staff was not saying an entity has a choice to follow either approach but that it should use the approach that gives the most useful information. Members concluded that a single accounting policy for a reporting entity consistently applied to a given set of facts and circumstances was required. The requirements of IAS 8 regarding the determination and application of an accounting policy would need to be followed.

The conclusion of the discussion was that both approaches were valid interpretations of IFRS 17 and thus an insurer would need to determine an appropriate accounting policy per the requirements of IAS 8 for the contracts it writes.

Determining Discount Rates Using the Top-Down Approach [AP02]

The second agenda paper considered issues related to the determination of the discount rate to be applied to cash flows that do not vary with the returns on the underlying items using the top-down approach. Specifically the submission asked whether the entity:

- Could use the assets held to support the group of insurance contracts as a reference portfolio of assets;
- Could ignore the liquidity characteristics of the group of insurance contracts being measured; and
- Should reflect in the discount rates any changes to the assets it holds when using them as a reference portfolio and does not adjust for differences in liquidity between

[1] The views expressed in this paper are based on the authors' observations from the TRG meeting. The IASB Staff's official summary may differ from the views expressed here.

the group of insurance contracts and the reference portfolio.

TRG members supported the Staff analysis that an entity needs to select an appropriate reference rate and there is nothing precluding the use of an entity's own assets as a starting point, but adjustments may need to be made in order for the reference rate to satisfy the requirements of paragraph 36 of IFRS 17.

The TRG members also supported the Staff view that IFRS 17 requires the discount rate to reflect the liquidity characteristics of the group of contracts that are being measured. There was discussion regarding the intended use of paragraph B81 in the standard which states that when applying the top-down approach the entity is not required to adjust the yield curve for differences in liquidity characteristics of the insurance contracts and the reference portfolio. TRG members agreed with the Staff view that B81 was not meant to allow entities to avoid reflecting the liquidity characteristics of the insurance contracts. All characteristics of the assets that are not present in the insurance contracts must be eliminated. The purpose of B81 was to differentiate from the bottom-up approach where an explicit adjustment would be required in respect of the liquidity characteristics of the insurance contracts.

A TRG member highlighted the importance of disclosures to help users understand movements in results when using the top down approach. They emphasized that very small changes to the composition of assets can have a large impact on the liabilities due to the long-tail nature of cash flows. Thus profitability can change materially even when the liquidity characteristics of the liabilities remains unchanged.

Commissions and Reinstatement Premiums in Reinsurance Contracts Issued [AP03]

The third agenda paper considered the accounting for a reinsurer for common types of commissions due to cedants and reinstatement premiums charged to cedants following the occurrence of an insured event to reinstate the original level of cover provided by the reinsurer.

The submission identified commissions that were contingent on claims and those that were not. For each of these types the question is whether they should be considered as part of the premium income or part of claims outgo, insurance acquisition cash flows or as an investment component. The submission differentiated between mandatory and voluntary reinstatement premiums and asked how these would be accounted for by a reinsurer.

The TRG was generally supportive of the Staff analysis with regard to the specific fact patterns laid out in the agenda paper, but some questioned how the Staff conclusions tied to specific requirements within IFRS 17. The Staff analysis noted that IFRS 17 does not provide specific requirements for determining whether exchanges between the entity and the policyholder are part of the premium or part of claims, except with respect to the presentation of income or expenses from reinsurance contracts held (paragraph 86). As a result the Staff analysis focused on the economic effect of the arrangements.

Some members expressed a concern that netting experience refunds against claims would obscure information about the true level of claims experience.

The Staff concluded that commissions paid to the ceding entity would likely not qualify as acquisition costs as they do not compensate the ceding entity for a service provided that is specific to the reinsurance contract.

The Staff concluded that ceding commissions could meet the definition of an investment component if they are repaid to the cedant in all circumstances. Additionally, a net settlement of the commission against the premium would economically make the commission a reduction in the premium and thus not a separate component of the reinsurance contract. If the ceding commission was paid at a different date from the premium it may qualify as an investment component.

Regarding the reinstatement premium some members noted an apparent inconsistency between premiums that pay for additional coverage and reinstatement premiums that pay for additional coverage. The Staff analysis indicates that reinstatement premiums would be treated as a reduction in claims. However, payment of premiums (other than restatement) for additional coverage would be treated as a premium cash flow for measurement purposes.

Premium Experience Adjustments Related to Current or Past Service [AP04]

The fourth agenda paper considered how differences between expected and actual premiums relating to current or past service are accounted for. In particular the submissions questioned whether these experience differences should adjust the CSM, and if not should they be recognized as insurance revenue or an expense.

The TRG agreed with the Staff analysis that any differences in premiums related to current or past service would not adjust the CSM and are recognized immediately in profit or loss. TRG members noted that it is not clear from IFRS 17 where in the statement of performance that the differences should be recognized. The Staff noted that the premium differences need to be disclosed separately in the notes to the financial statements and should be presented in insurance revenue in the statement of performance. Some TRG members suggested that adding a specific line item for these differences in illustrative financial statements would provide useful guidance.

Cash Flows that are Outside the Contract Boundary at Inception [AP05]

The fifth agenda paper considered issues related to cash flows for both insurance contracts issued and reinsurance contracts held that are outside the boundary at initial recognition. Specifically the submissions are focused on the interaction between paragraphs 35 and B64 of IFRS 17. Paragraph 35 identifies cash flows that are outside of the contract boundary and are therefore not recognized when measuring the current group of insurance contracts. Paragraph B64 states in part that the boundary of an insurance contract needs to be reassessed at each valuation date.

The Staff concluded that paragraphs 35 and B64 address different circumstances. The requirement in paragraph B64 is to be read in a very limited circumstance of applying the whole of paragraph B64 which considers the practical ability of the entity to reprice a contract. It applies to assessing the current contract. It does not apply to cash flows that are outside of the contract boundary.

The TRG was generally in agreement with the Staff's conclusions regarding the specific examples provided in the paper. Several TRG members noted that prior to the meeting they did not read paragraph B64 in the narrow terms that the Staff has.

TRG members noted that the fact patterns in the examples were related to renewal options that is focused on distinguishing the current contract from future contracts. They cautioned that the same logic would be difficult to apply to other types of options available on an existing contract.

Recovery of Insurance Acquisition Cash Flows [06]

The sixth agenda paper considered issues related to the recognition of insurance revenue in situations where insurance acquisition cash flows cannot be recovered from the cash flows of the group of contracts. A second issue explored was how to account for changes in insurance acquisition cash flows applying paragraphs B123 and B125 of IFRS 17.

The Staff concluded that any reduction in CSM or loss component recognized because insurance revenues are lower than expected cash outflows including acquisition cash flows, affects insurance revenue. Changes in expectations of insurance acquisition cash flows adjust the CSM which is recognized in insurance revenue. Experience adjustments in insurance acquisition cash flows also affect insurance revenue and potentially insurance expense.

TRG members generally agreed with the principle applied in the Staff's analysis.

Premium Waivers [AP07]

The seventh agenda paper considered issues related to the accounting for waiver of premium provisions in insurance contracts. Specifically, the submissions question whether the risk related to the premium wavier is a pre-existing risk transferred to the insurer or is a new risk created by the contract.

The Staff concluded that the risks that would trigger the waiver of premium benefit as outlined in the submissions were risks that pre-existed the insurance contract. As a consequence, the Staff also concluded that including a waiver of premium provision in an investment contract would make it an insurance contract and that including such a waiver on an insurance contract might change the quantity of benefits provided by the insurance contract, or the contract boundary or both.

TRG members agreed with the Staff's analysis.

Group Insurance Policies [AP08]

The eighth agenda paper considered issues related to the determination of the contract boundary for an arrangement between an entity and an association or a bank where the entity provides insurance coverage to the members of the association or customers of the bank.

The Staff analysis progressed through three steps:

- identify the policyholder;
- identify the insurance contract; and
- identify the contract boundary.

For each of these steps, the example highlights some considerations that arise from the specifics of the fact pattern. Firstly, the policyholder is not necessarily the entity with whom the insurer has contracted, such as the association or bank. Rather, the policyholder is the person who has the right to compensation if adversely affected by an insured event. Secondly, while the legal form of a contract would generally be considered to be a single contract for the purposes of applying IFRS 17 there are circumstances where the legal form of a single contract does not reflect the substance of its contractual rights and obligations. Thirdly, a contract's boundary is dependent on, among other things, the entity's practical ability to reprice the contract.

The TRG noted agreement with the steps of the analysis undertaken by the Staff, but noted that the facts and circumstances of any particular contract may lead to different conclusions.

Industry Pools Managed By an Association [AP09]

The ninth agenda paper considered issues related to the determination of the risk adjustment for non-financial risk for insurance contracts that are within industry pools managed by an association. As presented in the paper, the pools addressed in the submission are characterized by allocating the results of the pool to all members based on a specific sharing formula. The paper considers whether the risk adjustment for non-financial risk should be determined at the association level or at the member entity level and whether the reported risk adjustment could be different between the members and the association.

The Staff concluded that the risk adjustment is to be determined at the level of the entity that writes the contracts. Depending on the fact pattern that might be the individual member or the pool itself. The Staff noted that reporting entities are required to take into account the degree of diversification benefit that it includes when determining the compensation it requires for bearing non-financial risk which might include consideration of the pooling in which the entity intends to participate. Finally, consistent with the Staff's view on other issues considered at the TRG, they believe there can be only one risk adjustment for a given group of contracts.

TRG members generally agreed with the steps that the Staff went through in their analysis. Some TRG members felt the fact patterns provided in the paper were incomplete and that an evaluation of the full fact pattern may lead to different conclusions. Some TRG members noted that as in prior TRG discussions they disagreed with the view that there can only be one risk adjustment for a given group of contracts within a group insurance organization. Other members supported the single risk adjustment view.

Annual Cohorts for Contracts That Share in the Return of a Specified Pool of Underlying Items [AP10]

The tenth agenda paper considered the circumstances when the contractual service margin could be measured at a higher level than at an annual cohort level.

The Staff concluded that the requirements of paragraph B68 of IFRS 17 compel the reporting entity to reflect the extent to which the cash flows of each group of insurance contracts affect the entity.

In the fact pattern provided where contracts share in 100% of the return on the underlying performance of the insurance contracts, there is no CSM. Thus, there is no difference between determining the CSM at an annual cohort and at a higher level.

For the fact pattern provided where the contracts share in less than 100% of the return on the underlying items, there may be differences between measurement of the CSM at an annual cohort level and a higher level. The example presented in the paper had a fact pattern where all cash flows were able to be determined at the annual cohort level. In this situation, the CSM would be different if determined at a higher level of aggregation.

In order to use a calculation at a higher level of aggregation, the Staff noted that the insurer needed to be convinced in advance that the same result would occur relative to measuring at the annual cohort level in all circumstances.

The TRG had significant discussion of the example where there was less than 100% sharing in the returns on the underlying returns. Many members agreed that the application of paragraph B68 to the specific fact pattern led to the Staff's conclusion. Some members commented that there were facts that were not supplied in the submission (e.g., whether the sharing of returns applied before or after the guaranteed payment of benefits) that made it difficult to determine whether the Staff's conclusion was appropriate. Many TRG members felt the example was unrealistic or too extreme.

Reporting on Other Questions Submitted [AP11]

The eleventh agenda paper considered issues raised in other submissions that were not brought to the TRG through the first ten agenda papers. These submissions were not brought to the TRG because, in the Staff's view, they either:

- can be answered applying only the words in IFRS 17 (in other words, the Staff believe there is no ambiguity around the interpretation of the words);
- do not meet the submission criteria; or
- are being considered through a process other than a TRG discussion.

TRG members noted that the Staff responses to topics S56 and S57 were helpful in clarifying that financial reports may differ based on the frequency of reporting. In particular the determination of the CSM may differ.

Several TRG members noted that it would be useful to have a discussion regarding the accounting for mutual enterprises. The Staff noted that the issues raised to date (e.g., S21, S45) did raise interpretation questions and they felt the education documents available on the IASB's website were addressing the need.

Several TRG members indicated that issue S33, that questioned whether a range of specific types of contract would be in scope of IFRS 17, was going to be a large implementation issue and that companies that are not insurers but which issue contracts that are within the scope of IFRS 17 may be unaware of this fact. They suggested some outreach or elevation of the issue would be useful.

Conclusion

Many of the submissions discussed during the September TRG meeting did not generate as much debate as has been seen in previous TRG meetings. This is clear from the fact that seven papers were discussed on the first day relative to the five that were scheduled on the agenda.

As many of the submissions questioned very specific fact patterns, the Staff and IASB Board members attending the TRG appear concerned that the discussion of the TRG on such narrow issues is not providing the desired level of guidance for the industry as it implement the Standard. Therefore the IASB encourages industry participants to submit questions that better address the broader interpretation issues arising from the Standard rather than very product specific queries.

Whether the next TRG meeting is delayed until Q1 2019 is likely to depend on the quality of submissions received by the TRG.

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