Summary of the Transition Resource Group for IFRS 17 *Insurance Contracts* meeting held on 4 April 2019

1. The Transition Resource Group for IFRS 17 *Insurance Contracts* (TRG) held a meeting on 4 April 2019 at the London office of the IFRS Foundation. These notes summarise the discussions.

2. Agenda Paper 2A for the May 2019 meeting of the International Accounting Standards Board (Board) provides the Board with a copy of this summary.

3. The discussions at the TRG meetings are based on the agenda papers that provide an accounting analysis of implementation questions submitted to the TRG. These agenda papers provide a basis for TRG members, as industry experts involved in IFRS 17 implementation, to understand the implementation questions raised and share their views on the accounting analysis. Although the analysis in an agenda paper may be relevant to other fact patterns, all relevant facts and circumstances of a particular fact pattern need to be evaluated when applying IFRS 17.

4. TRG members discussed investment components within an insurance contract and received a report on other questions submitted.

Investment components within an insurance contract (Agenda Paper 1)

5. Agenda Paper 1 addresses submissions about investment components as defined in IFRS 17. The submissions question how to:

   (a) determine whether an insurance contract includes an investment component;

   (b) assess whether an investment component is distinct; and

   (c) determine the amount of an investment component.

6. The paper analyses the requirements of IFRS 17 relevant to those questions and uses some examples of insurance contracts to illustrate the analysis provided.

7. TRG members discussed the analysis in Agenda Paper 1 about determining whether an insurance contract includes an investment component and observed that:

(a) an investment component is defined in Appendix A of IFRS 17 as the amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur. Paragraph BC34 of the Basis for Conclusions on IFRS 17 explains that an investment component is an amount that is paid to the policyholder *in all circumstances*. The staff noted the recommendation in Agenda Paper 2D *Annual improvements* for the April 2019 Board meeting that the Board propose an annual improvement to that definition to better reflect the Board's intention and to include explicitly the requirement that an investment component is the amounts that an insurance contract requires the entity to repay to a policyholder in all circumstances.

(b) to determine whether an insurance contract includes an investment component, an entity assesses whether the contract requires the entity to repay amounts in all circumstances. In this assessment an entity considers the following factors:

(i) whether scenarios in which no payments are made have commercial substance; and

(ii) if there are circumstances in which a payment could be determined to be zero, what the terms of the contract indicate about that payment of zero.

8. TRG members also observed that it would be helpful to clarify the definition of an investment component in IFRS 17 to explicitly include the requirement that amounts be repaid to the policyholder in all circumstances. However, some TRG members observed that a clarification of the definition is not needed and could be disruptive.

April 2019 Board meeting

Agenda Paper 2D *Annual improvements* for the April 2019 Board meeting included a recommendation that the Board amend IFRS 17 to clarify the definition of an investment component. The Board noted the feedback from the TRG discussion described in Agenda Paper 2E *Supplement to Agenda Paper 2D Annual improvements–feedback from the TRG meeting held on 4 April 2019* for that meeting.

9. TRG members discussed the analysis in Agenda Paper 1 about assessing whether an investment component is distinct and observed that an investment component within an insurance contract is not distinct if the investment component and the insurance component are highly interrelated—ie when:

   (a) it is not possible to measure one component without considering the other. This could be the case when the contract requires the entity to make payments for which either the amount or the timing depend on the insured event.

   (b) the policyholder cannot benefit from one component if the other is not present. The lapse or maturity of one component causing the lapse or maturity of the other component is sufficient to conclude that the two components are highly interrelated. For example, the lapse of the insurance component causing the lapse of the investment component is sufficient to conclude that the two components are highly interrelated, even if the lapse of the investment component does not cause the lapse of the insurance component. A contractual term preventing the policyholder from cancelling the investment component or the insurance component or both may indicate that the policyholder cannot benefit from one component without the other.

10. TRG members also observed that the hurdle for separation of investment components from an insurance contract is high.

11. TRG members discussed the analysis in Agenda Paper 1 about determining the amount of an investment component and observed that:

   (a) an entity identifies amounts of a non-distinct investment component only when insurance revenue and incurred claims are recognised.

(b) IFRS 17 does not specify how to determine those amounts.

(c) in some cases, it may be reasonable to determine the amount of the investment component that an entity is required to exclude from insurance revenue and insurance service expenses using the explicit amount identified by the contractual terms. For example, the amounts of a non-distinct investment component can be identified as an explicit surrender amount or explicit guaranteed payments.

(d) in other cases, it may be appropriate to determine the amount of the investment component that an entity is required to exclude from insurance revenue and insurance service expenses on a present value basis at the time of making the determination. For example, in an uncancellable contract that requires an entity to pay the policyholder an amount when the policyholder dies or reaches the age of 80, using the present value of the payments the contract requires the entity to make at the age of 80 would result in a reasonable outcome because death in early periods of coverage would reflect a higher insurance claim than in later periods.

12. TRG members also observed that:

(a) if an entity uses an explicit surrender amount for determining the amounts to be excluded from insurance revenue and insurance service expenses, it is not required to determine whether a part of that amount reflects a premium refund. TRG members noted that both an investment component and a premium refund will be excluded from the revenue and expenses recognised for the contract in these circumstances.

(b) paragraph 103 of IFRS 17 requires an entity to separately disclose—in the reconciliation from the opening to the closing balance of the insurance contract liability—investment components excluded from insurance revenue and insurance service expenses. TRG members noted that the disclosure requirement refers only to investment components and does not include premium refunds. They observed that it may be helpful to consider whether a consequential amendment should be proposed to this disclosure requirement.

Reporting on other questions submitted (Agenda Paper 2)

13. Agenda Paper 2 considers submissions to the TRG that:

    (a) can be answered applying only the words in IFRS 17;

    (b) do not meet the submission criteria; or

    (c) are being considered through a process other than a TRG discussion (such as a proposed annual improvement).

14. TRG members made the following observations:

    (a) *S92 Policyholder dividends*

    Agenda Paper 2 notes that changes in fulfilment cash flows that result from changes in underlying items should be treated for the purposes of IFRS 17 as changes in investments and therefore as changes in assumptions that relate to financial risk, irrespective of the type of underlying items. As such, applying paragraph 87 of IFRS 17, the changes are included in insurance finance income or expenses. Agenda Paper 2 also notes that the staff will consider whether this needs to be clarified through an annual improvement in the forthcoming Exposure Draft of proposed amendments to IFRS 17.

    TRG members observed that, consistent with the general model in IFRS 17, changes arising from underlying items should not adjust the contractual service margin for insurance contracts without direct participation features and therefore they support a clarification through an annual improvement in the forthcoming Exposure Draft. Two TRG members expressed the view that presenting changes resulting from changes in non-financial assumptions related to underlying items as part of the insurance service result—rather than the insurance finance income or expenses as clarified by the proposed amendment to IFRS 17—would provide more useful information to users of financial statements.

    One TRG member also questioned whether treating all changes in underlying items as arising from financial risk for the purpose of IFRS 17 would affect other requirements in the variable fee approach, for example, applying the risk mitigation option.

April 2019 Board meeting

Agenda Paper 2D *Annual improvements* for the April 2019 Board meeting included a recommendation that the Board amend IFRS 17 to clarify that changes in the measurement of a group of insurance contracts caused by changes in underlying items should be treated as changes related to the time value of money or assumptions that relate to financial risk. The Board noted the feedback from the TRG discussion described in Agenda Paper 2E *Supplement to Agenda Paper 2D Annual improvements–feedback from the TRG meeting held on 4 April 2019* for that meeting.

(b) *S101, S120 & S124 Changes in the risk adjustment for non-financial risk due to time value of money and financial risk*

Agenda Paper 2 notes that the staff plan to clarify as an annual improvement in the forthcoming Exposure Draft that the choice made applying paragraph 81 of IFRS 17 would result in different adjustments to the contractual service margin. One TRG member reads the choice provided in paragraph 81 of IFRS 17 as a choice that is limited to presentation requirements only and would not have expected it should affect the measurement of the contractual service margin.

April 2019 Board meeting

Agenda Paper 2D *Annual improvements* for the April 2019 Board meeting included a recommendation that the Board amend IFRS 17 to address disaggregation of changes in the risk adjustment for non-financial risk. The Board noted the feedback from the TRG discussion described in Agenda Paper 2E *Supplement to Agenda Paper 2D Annual improvements–feedback from the TRG meeting held on 4 April 2019* for that meeting.

(c) *S115 Definition of insurance contracts with direct participation features—mortality cover*

S115 includes an example of an insurance contract that gives the policyholder the returns on underlying items, after deducting an annual management fee determined as a percentage of the fair value of the underlying items. The staff clarified that, in this example, a fixed annual charge for mortality cover reduces the underlying items at the start of each year. A TRG member observed that a distinguishing circumstance in the example is that the premium for mortality cover is fixed rather than varying with the fair value of the underlying items. The staff confirmed that the analysis in Agenda Paper 2 is based on the mortality charge being a fixed amount and that analysis might differ had the charge varied with the fair value of the underlying items. TRG members observed that when determining whether an insurance contract is in the scope of the variable fee approach (insurance contract with direct participation features), in some circumstances, it may be necessary to consider the way a charge is determined, rather than the way it is labelled in the contract, to identify what the charge represents.

(d) *S118 Consideration of reinsurance in the risk adjustment for non-financial risk*

TRG members observed that if an entity considers reinsurance when determining the compensation it requires for bearing non-financial risk, the effect of the reinsurance would be reflected in the risk adjustment for non-financial risk of the underlying insurance contracts. The effect of the reinsurance includes the cost of the reinsurance as well as the benefits.

TRG members also observed that the measurement of the risk adjustment for non-financial risk of a reinsurance contract held is the amount of risk transferred to the reinsurer.

(e) *S122 Changes in fulfilment cash flows as a result of inflation*

Agenda Paper 2 notes that amounts that an entity expects to change with an index are considered to be an assumption that relates to financial risks, even if they are not contractually linked to a specified index (for example, a TRG member mentioned that some entities use inflation indices to anticipate their future expense for salaries, which increases over time). Before reading Agenda Paper 2, some TRG members had read 'assumptions about inflation *based on* an index or prices or rates…' in paragraph B128 of IFRS 17 as applying only when that basis is specified in the terms of the insurance contract.

Next steps

15. From February 2018 to April 2019 there have been four TRG meetings covering all 127 submissions up to April 2019. The TRG Chair noted that:

    (a) many submissions for the last two TRG meetings cover mechanical or narrow aspects of the requirements in IFRS 17 or include specific fact patterns as many entities are now at an advanced stage of IFRS 17 implementation.

    (b) at present, no further TRG meetings are scheduled. Stakeholders can continue to submit implementation questions that meet the submissions criteria to the TRG as those questions arise. A TRG meeting may be scheduled in the future depending on the nature of any new submissions and whether discussion of those submissions would provide helpful education to stakeholders at this stage of implementing IFRS 17, without disrupting implementation processes under way.

    (c) comments or questions relating to the forthcoming Exposure Draft of proposed amendments to IFRS 17 should be included in comment letters to that Exposure Draft.