Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Meeting Summary
Hong Kong Insurance Implementation Support Group (HKIISG)
20 April 2018

Attendance
HKICPA representatives
Sanel Tomlinson, Member, Financial Reporting Standards Committee (FRSC)
Christina Ng, Director, Standard Setting
Kam Leung, Associate Director, Standard Setting

HKIISG members
Sai-Cheong Foong, AIA Group Limited
Ronnie Ng, China Overseas Insurance Limited
Sally Wang, China Pacific Life Insurance Co., Ltd
Kevin Wong, FWD Life Insurance Company (Bermuda) Limited
Irene Leung (representing Alexander Wong), Hang Seng Insurance
Kenneth Dai, Manulife Asia
Candy Ding, Ping An Insurance (Group)
Carrie Yip (representing Nigel Knowles), Prudential Hong Kong Limited
Joyce Lau, Target Insurance Company, Limited
Doru Pantea, EY Hong Kong
Francesco Nagari, Deloitte Hong Kong
James Anderson (representing Erik Bleekrode), KPMG China
Chris Hancorn, PwC Hong Kong

Apologies
Kevin Lee, AXA China Region Insurance Company Limited

Discussion objectives:
Readers are reminded that the objective of the HKIISG is not to form a group consensus or decision on how to apply the requirements of HKFRS/IFRS 17 *Insurance Contracts*. The purpose of HKIISG is to share views on questions raised by stakeholders on the implementation of HKFRS 17. Refer to HKIISG terms of reference.

The meeting summaries of HKIISG discussions are solely to provide a forum for stakeholders to follow the discussion of questions raised. Stakeholders may reference HKIISG member views when considering their own implementation questions—but should note that the meeting summaries do not form any interpretation or guidance of HKFRS 17.

1. Opening remarks

Members agreed that the submission log and meeting summaries of each HKIISG meeting would be circulated electronically for members to comment on. If no comments are received within the comment period, they would be posted on the HKICPA website for educational purposes. HKICPA staff reminded members that the documents would be promoted through the HKICPA's various communications channels, and that the HKICPA's subscribers for insurance updates would also be notified.

HKICPA staff reminded members that the objective of HKIISG discussions is to have open discussions regarding implementation challenges/questions, with members sharing views on how the principles of the standard could be applied. The objective of discussion is not to form a group consensus.

2. Consider HKIISG submissions received by 9 April

Follow up actions from last meeting

HKICPA staff updated members that the:

- HKICPA's Insurance Regulatory Advisory Panel and the Insurance Authority will meet on June 5 to discuss possible ways in which the IA can leverage HKFRS 17 requirements in the development of its new Risk Based Capital regime; and
- March 20 meeting paper 5C had been referred to the IASB staff for further clarification. The question is: what discount rate should be applied at initial recognition of a group of

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contracts when the option to disaggregate insurance finance income and expenses with a weighted average discount rate is elected. HKICPA staff will update members on the IASB staff response when it is received.

Relating to the March 20 meeting papers 5A and 5B, members were reminded to submit examples on commonly seen base policies and riders, and an analysis on how the separation of components in insurance contracts may or may not be applied. To date, one member has submitted examples. HKICPA staff will bring back a paper for discussion when there are more examples received.

Paper 2A
Mr. Kevin Wong of FWD Life Insurance introduced paper 2A which outlined the following observations:

- Paragraph B132(a)(i) requires a constant rate to be used to determine systematic allocation when the OCI approach is elected.
- Paragraph B130(b) requires amounts recognized in OCI over the duration of the group of contracts to equal zero.
- However, an insurance contract normally has net cash flows which can be positive or negative at different points in time, and therefore there may be situations where no constant rate can be derived, mathematically. That is, the OCI cannot equal zero over the duration of the group of contracts if a single constant rate for systematic allocation is used. Refer to supplement example provided.

The question is whether the proposed alternative approaches in paper 2A still fulfills the requirements of IFRS 17.

Proposed approach 1: Abandon OCI option in these scenarios
Members commented that in the scenario described, there is no satisfactory mathematical solution which would derive a constant rate and result in the OCI balance equaling zero over the duration of the group of contracts.

However, members did not support abandoning the OCI option in this scenario, as they think that it is not the IASB's intent to create an impracticable (i.e. mathematical insolvable) IFRS 17 requirement.

Proposed approach 2: Different constant rates for the positive and negative cash flows
Several members expressed support for this approach, which is to have one rate for the positive cash flows, and another rate for the negative cash flows. One member argues that this approach is the closest application of the principles in IFRS 17 paragraphs B132 and B130 which requires the systematic allocation to be at a constant rate, and the OCI balance to equal zero over the duration of the group of contracts, respectively. This member notes that by applying this approach, insurers would be able to:

- demonstrate that each OCI balance created by the positive and negative cash flows respectively, would equal zero; and
- avoid any mathematical anomaly. Furthermore, since the two constant rates would be independent of one another, the approach is sustainable until contract derecognition.

Another member commented that theoretically, the rate for systematic allocation should be driven by its originating cash flow, not a net combined positive/negative cash flow.

Proposed approach 3: Apply discount rate used at initial recognition until a solution is found
No comments were made by members on this approach. However, one member suggested using a weighted average rate adjusted on a time basis, until one day there is a mathematical solution.

Other comments
Some members commented that it is a matter of judgment how an entity would arrive at a constant rate that is reasonable for their particular scenario in accordance with the principles of IFRS 17. One member further noted that the example in IFRS 17 is simple and therefore may not be representative of real life scenarios—this member noted that an insurer should be able to find other ways to derive constant rates for systematic allocation that are reasonable, without following the simple example in IFRS 17.

One member noted that the discussion on the specific method which is acceptable for the purposes of meeting the requirements of IFRS 17 should be a conversation between the insurer and its auditor.

Conclusion:
Overall, members did not think that there was any further follow up necessary on this question.

Paper 2B
Ms. Joyce Lau of Target Insurance introduced paper 2B. The question was related to the premium allocation approach (PAA). The paper observed that if the facts and circumstances of a group of insurance contracts measured under PAA indicate that they are onerous, the fulfillment cash flows relating to the remaining coverage of the group need to be measured under the general measurement model. The question is how, and on what basis, management expenses should be allocated to insurance contracts in these cases.

Judgment is required
One member referred to paragraph B65 in IFRS 17 and noted that all directly attributable expenses should be counted in the calculation of fulfillment cash flows (FCF). Therefore, this member thinks it would be reasonable that a portion of the management expenses are allocated to the FCF, but noted that a detailed analysis of each category of expense would be required before determining the portion to be allocated.

A member commented that the requirement of the standard is clear, but observed that what is considered "directly attributable" is a difficult question for industry to answer. This member noted that the proportion of management expenses allocated to FCF would have to take into account an analysis of the insurers' business model and its products.

Other comments
Operationally, one member suggested monitoring the loss ratio of the group of contracts which apply the PAA model. When the loss ratio reaches a certain threshold, the data arising from the group of contracts under the PAA model should be measured under the general measurement model to determine if it is onerous.

Two members commented that the regulatory returns to the Insurance Authority which demonstrate large underwriting losses in the insurance business classes of Employees' Compensation and Motor Vehicle, Damage and Liability (referred to in paper 2B) may not be indicative of IFRS 17 results since the calculation methodology is different (for example, regulatory returns do not include the impact of discounting). However, another member responded that the reference to the large losses in the regulatory returns seeks to raise awareness among general insurers that the allocation of management expenses is a very important consideration in determining whether a group of contracts is onerous and therefore whether the group of contracts is eligible for the PAA model at initial recognition.

Members commented that education for the industry is required, in particular on how to determine whether insurers are eligible to apply the PAA model. One member noted that the Hong Kong Federation of Insurers taskforce for IFRS 17 had floated the idea of preparing a series of Q&As targeted to common questions that the industry has. This would provide a quick and understandable touch point for insurers to reference. HKICPA staff also provided members with an update on plans for education, noting that a series of pocket guides targeted to general insurers will be published to help them implement HKFRS 17. The scope of the pocket guides will be driven by key question areas, such as PAA model and the assessment of onerous contracts.

Finally, one other member commented that the question of how to allocate management expenses is not limited to general insurers, and that it also significantly impacts life insurers. Another member suggested that the insurance industry could make reference to the methodologies applied by other industries for expense allocation.

Action/Conclusion:

HKICPA staff will include this topic in future training seminars and educational materials and work closely with the Hong Kong Federation of Insurers so that member companies are familiar with the requirements of HKFRS 17, and to monitor implementation developments. On a separate note, the Institute's Insurance Regulatory Advisory Panel will meet with the Insurance Authority to discuss recommendations on how to leverage HKFRS 17 requirements in developing its risk based capital solvency framework.

Post-meeting Note: On 7 May 2018, the first pocket guide in the series was published and promoted through the Institute's communication channels. Stakeholders who had opted to receive notifications from the Institute regarding HKFRS 17 also received this publication.

3. Consider 2 May IASB TRG meeting papers

Members had an initial discussion on IASB TRG Papers AP01, AP02 and AP05. At its 27 April meeting, HKIISG members discussed all IASB TRG Papers.

To facilitate easy reading, this portion of the meeting summary has been combined with the 27 April meeting summary.

4. Any Other Business

HKIISG will continue discussion on the remaining IASB TRG papers at the April 27 meeting.

Finally, HKICPA staff updated HKIISG members on the existence of similar implementation support groups in Australia, Canada, and Germany. It was proposed to invite these groups to any forums that HKIISG may hold with Hong Kong stakeholders at the end of the year.